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Choosing Coalition Partners: The Politics of Central Bank Independence in Korea and Taiwan

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Choosing Coalition Partners: The Politics of Central Bank Independence in Korea and Taiwan

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Dedication

To my wife

Acknowledgements

I've waited for a long time to write this. I spent most of my thirties in Austin, Texas. It seems that I have been out of a dark tunnel to see a light. I remember I studied all through the night at a computer lab of the Burdine Hall doing statistics homework in first and second years. I liked to run along the Town Lake and mountain bike a rocky single track along the Barton Spring Green Belt under the sizzling Texas sun. I can never forget my time that I spent here in Austin, Texas.

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My mother passed away three years ago. She could not see me earn a Ph.D. in the U.S., which is a scar marked on my heart for good. She was born to a peasant couple in a poor rural village during the Japanese colonial period; She grew up seeing the Korean War; she was married to an officer of spirit; she bore a daughter and two sons; she took care of her husband who often returned home exhausted from hard working during tiring industrialization; she looked after her kids who struggled to win the class struggle titled "education." After all, she did nothing for herself. She's gone. But I feel she is always with me, especially when I run and mountain bike.

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Choosing Coalition Partners: The Politics of Central Bank Independence in Korea and Taiwan

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This study is to explain why Taiwan's elites delegate the independent authority of financial and monetary management to central bankers which resulted in survival of the Asian crisis, while Korean political leadership did not do so and the economy faltered in the crisis? My arguments are 1) if politicians choose capital-intensive industry and/or organized labor as their major coalition partners, they will not allow central bankers to have an independent authority; 2) if politicians choose other groups as their coalition partners (i.e., commercial banks, agriculture, and/or small-medium sized enterprises), they will be more likely to provide central bankers with independent authority. In addition to the two cases studies, I explore three Southeast Asian countries (Singapore, Malaysia, and Thailand). By employing statistical analyses to test the generalizability of my arguments in the context of developing countries, I confirm the hypotheses. Implications of my study include 1) the state needs to include subordinate social groups to counterbalance big bourgeoisie, especially in the globalization era; and 2) merely institutional or economic reform does not guarantee an independent central banking system; rather it is necessary to include heterogeneous social groups into the growth coalition to support effective central banking systems from below.

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Chapter 1: The Politics of Central Bank Independence

In July 1997, neighboring Asian countries experienced a turbulent wave of financial crisis triggered by a massive run on the Thai baht. Within a year, about 150 financial institutions were shut down, merged, or sometimes nationalized by the hard-hit governments' urgent decrees (Far Eastern Economic Review April 4, 1998: 81). The crisis caused bankruptcies as well as other socioeconomic turmoil such as skyrocketing unemployment rates, nose-diving GDP growth rates, economic restructuring forced by IMF's emergency loans, a severe cut of social welfare expenditures, and psychological depression in affected countries' citizens. According to Robert Wade, the Asian crisis was the regional equivalent of "the Great Depression of the 1930s in terms of the scale of the falls in output and consumption and the increase in poverty and insecurity. Countries have been pushed back down the hierarchy of world income to where they were 10 years ago and more in terms of per capita income measured at current exchange rates" (1998: 1-2).

Although the effects of the sweeping Asian crisis affected most of all the countries in Asia, the effects varied. For example, Korea, Indonesia, Thailand, and Malaysia were badly hit and collapsed, while the Taiwan and Singapore economies survived the crisis. Some in-between cases included Hong Kong, Vietnam, Philippines, Burma, and China, which were shaken but did not fall.

Interestingly enough, two leading Asian NICs – Korea and Taiwan – were a stark contrast. Why did Korea stumble while Taiwan managed to survive? They share many similarities, such as Confucian cultural traits, a common historical experience of Japanese colonialism, efficient bureaucrats, strong and autonomous states, divided nation-states, propinquity of communist threat, export-oriented open economies, concurrent stages of economic development and democratic transition, successful land reforms, and U.S. pressure and aid since World War II. Furthermore, the countries have been praised for their outstanding economic performance, dubbed the Asian "economic miracle" in academic circles. For example, while other upper and lower middle income countries' GNP per capita increased 5.55 times and 5.46 respectively from 1965 to 1994, the indicators for Taiwan and Korea are 53.48 and 67.84 in the same period (World Bank 2003).

In fact, the "Asian flu" is not an exception if one sees the banking crises in a longer historical perspective. The high frequency of financial crises may characterize the globalization of the international economy since the 1980s. An IMF study revealed that during the period spanning 1980 through 1996, 133 of the IMF's 181 member countries experienced significant banking sector problems (Lindgren, Garcia, and Saal 1996). Another study shows that the past two decades have seen 90 serious banking crises, most of them followed by deep recessions. More than 20 of these crises produced direct losses to the developing countries exceeding, on average, 10 percent of their gross domestic products. In half of these cases, including several Asian countries, losses exceed 25 percent of the countries' GDP (Caprio and Klingebiel 1996).

Financial liberalization during the past decades, by giving banks and other financial intermediaries more freedom of action, has increased opportunities to pursue high-return but high-risk investment projects. "Bankers' appetites for risk are likely to be far greater than what is socially desirable. Liberalization may increase financial fragility if prudential regulation and supervision are not effective at controlling bank behavior and at realigning incentives" (Demirguc and Detragiache 1998: 11).

Much of the political economy of financial crises relates to central banks' authority, since central banks are responsible for the financial regime; they seek to control the money supply, protect financial stability, regulate and supervise domestic and even foreign financial intermediaries, guarantee the domestic and international payment system, and provide some range of financial services to the government.

Yet, whether or not central bankers perform the role that they are expected to do depends on politicians' willingness to provide central bankers with independent authority to control the whole financial system. Thus a critical issue during financial liberalization era is whether a government allows a central banking system to efficiently control the financial market to fend off financial malaise. In fact, Taiwan's central bankers were allowed to be effective in regulating and supervising their financial system which helped the country survive the Asian crisis, while their Korean counterparts did not. So the question boils down to "why did Taiwan's elites delegate the independent authority of financial and monetary management to central bankers which resulted in survival of the Asian crisis, while Korean political leadership did not do so and as a result, the economy faltered in the crisis?" The dependent variable of my study is the different levels of central bankers' independent regulatory authority in Taiwan and Korea. My examination of this problem begins with a review of the existing literature.

I. Democratic Accountability and Policy Coordination: Anti-CBI Literature

The literature provides two opposing views on the relationship between the government and the central bank. One view argues that a central bank has to be a governmental agent in general, accountable to a finance ministry who oversees its monetary and financial policies.

The other view regards the central bank's independence (CBI, hereafter) as a given to study various sources from which central bankers enjoy institutional independence from governments. Some scholars pay attention to the motives and incentives that politicians have to give CBI; others emphasize the relationship between central bankers and social actors to explain varying degrees of CBI. The former can be called a "government-sided theory" and the latter a "society-sided theory." I will consider each view of the CBI, pointing out how they explain variations of the CBI and what shortcomings they exhibit with regard to my question. First, let me start with the anti-CBI literature.

A problem that central bank critics point out is democratic accountability. Central bankers are powerful enough to determine winners and losers in an economy, yet they are shielded from democratic control by their own secret technocracies. Radical scholars such as Magdoff and Sweezy argue that the central bank acts like the executive committee of the capitalist class. According to them, although central bankers may often make monetary and financial decisions unfavorable to specific capitalists, they always function in the interests of the capitalist class as a whole (Magdoff and Sweezy 1987).

In the same vein, Greider (1987: 11-12) argues that the U.S. central bank is *rentier*, making policy in the interests of the finance fraction of capital, and is a threat to democracy in the U.S. He criticizes central bankers as follows:

> It (the Federal Reserve System) provided another mechanism of government, beyond the reach of the popular vote, one that managed the continuing conflicts of democratic capitalism, the natural tension between those two worlds, "democracy" and "capitalism." … Indeed, it had the power to resist the random passions of popular will and even to discipline the society at large. The Federal Reserve System was the crucial anomaly at the very core of representative democracy, an uncomfortable contradiction with the civic mythology of self-government. Yet the American system accepted the inconsistency.

Gerald Epstein, after studying European social democracy, is also critical of the expanded role of non-democratic central banks which damage what Przeworski once called the "class compromise"(Przeworksi 1985) between capitalists and labor. "Independent central banks can thwart a Keynesian coalition of labor and industry that supports expansionary policy; and they can veto expansionary policy that a labor-led social democratic government might support" (Epstein 1992: 13).

Another problem with CBI is that central banks often undermine monetary / fiscal policy coordination, since they speak for (financial) capitalists while democratic governments speak for collective desires of the voting population. Sargent commented on the coordination problem as follows (New York Times August 12, 1983):

> The Federal Reserve has resolved to stick to a policy that is feasible only if the budget is approximately balanced, while Congress and the Executive Branch together determine prospects for taxes and spending that are feasible only if the central bank eventually becomes passive and accommodative. With such mutually infeasible prospects, all that is certain is that one side or the other must eventually give in. Outside parties are thrust into the uncertain position of betting on which side in the game of chicken will eventually capitulate and on how and when.

Likewise, naming the relationship between the government and central bankers "a car with two drivers," Greider also criticized the relationship by saying that "while the Federal Reserve was confronting inflation with tight money and high interest rates, the Reagan government was embarking in the opposite direction. Ronald Reagan wanted to reawaken the industrial giant while Paul Volcker wanted to sedate it" (1987: 358).

The policy disagreement leads central bankers to their monetary overreaction to fiscal agency. “If the central bank anticipates a more expansionary fiscal policy than it believes desirable, it might implement tighter money policy than otherwise called for, in turn leading the fiscal authority to hold fast to its expansionary path” (Maxfield 1997: 15). Monetarists and neoclassic economists argue for the CBI, but a central bank is an institution that leads to suboptimal outcomes for social welfare.

Anti-CBI studies raise some fundamental concerns about democratic accountability and policy coordination that most central bank studies ignore. But even though the Federal Reserve looks removed from democratic controls, it may be consistent with democratic theory for several reasons: it is based on authority delegated by the Congress; the basic goals of monetary policy are set legislatively; the leaders of the Federal Reserve are appointed by the President; and Congress retains ultimate control in case of dire emergency (Blinder 1996). Furthermore, the democratic delegation of the monetary and financial spheres from elected officials to a central bank is rationalized by the fact that the spheres need to be protected from political manipulation and electoral pressures of the self-interested private social groups.

As for the fiscal/monetary policy coordination problem, institutional independence that central bankers enjoy does not always lead to policy conflicts between a government and a central bank. A central bank as ‘the bank of government’ has an inherently close relationships with government. Sometimes they cooperate with each other. Furthermore, a lack of coordination can stem not from central bankers but from the government. For example, the problem may originate from the ruling politicians’ desire to boost up the economy by showering cheap credits to their constituent so as to win an upcoming election. In this sense, “the central bank can be seen as the repository of reason against the short-term claim of passion” (Elster 1979: 89). If central bankers collude with government politicians to make “perfect” policy coordination, the collusion may lead to a disaster such as hyperinflation with budget deficits as often happens during war time. The CBI functions as a system of “check and balances.”

The anti-CBI critics may overemphasize the seamy side of CBI. More importantly, they do not answer why some governments provide central bankers with the independent authority to manage the whole financial system while others don’t. This dissertation is not about the legitimacy of the central bank itself in a capitalistic democracy; it is about the causes of varying degrees of CBI, taking for granted that the existence of a central bank in a country is a given. In fact, almost every country has a central bank or a substitute, no matter how independent it is.

II. Government-Sided Explanations of Central Bank Independence

The 'government-sided' theories of CBI come from the notion that central banks have to gain "permission" from government politicians or finance ministries to start their own central banking businesses. The historical origin of the central bank shows that this is the case (Goodhardt, Capie, and Schhadt 1994). The Bank of England started from a special commercial bank which received charters from the English government allowing them monopolistic privileges to issue notes. In exchange, the special private bankers took the burden on their shoulder to mobilize financial resources for funding the English government's budget deficits caused by war efforts. In fact, "Britain's superior financial, economic, and military performance after 1689 rested in large part on the establishment of the Bank of England. The bank provided a commitment technology that improved the government's ability to borrow, a need impelled by intense military competition" (Broz 1998: 231). As in the case of the origins of the English central bank, government-sided explanations of central banks pay attention to motives and incentives that government politicians have when deciding how much CBI they want to allow to the central bankers.

Given that the central bank provides a lot of benefits to the government, why do all politicians not support CBI? If one considers the standpoint of elected officials, it is not easy to provide central bankers with independent authority because: 1) politicians and their constituencies benefiting from previous "financial repression" [1] (McKinnon 1973; Shaw 1973) may resist financial deregulation and an independent central banking system over which they have less control; 2) an authoritative central bank in charge of monetary policy often undermines policy coordination with the fiscal ministry; and 3) they just do not want to relinquish their political power to determine "who gets what and how."

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[1] In a "repressed" financial system, the government maintains artificially lower interest rates. Because this induces an excess demand for credit, the government is drawn into the process of rationing financial

Thus the CBI literature focuses on policymakers' preferences and interests under conditions of political competition: do politicians allow CBI because they want to do what their partisan preference dictates? because they want to win an upcoming election? because rightist politicians want to influence monetary and financial regimes after their opposition party wins an election? or because government elites need money to fund their budget deficits?

Governments' Partisan Affiliations and CBI

Some political economists argue for an affinity between central bankers' authority and the partisan affiliation of government. The preference of leftist governments has been for relatively low unemployment at the cost of high rates of inflation, whereas comparatively low inflation and high unemployment characterize political systems dominated by center and right-wing parties (Hibbs 1977; Alesina 1991). Consequently, leftist governments are likely to prefer that central bankers be dependent on the government agencies in charge of spending and planning, to enhance economic growth and employment, while rightist governments tend to let central bankers assume independent monetary and financial responsibility to secure price and financial stability.

But partisan affiliation-based policy differentials are neither clear-cut nor consistent in the real world. John Goodman argues that the "ideological desire" of a party in government is not necessarily equal to the "capability" to implement its preferred policy. For example, German and French political parties often prefer what the partisan model expects. The ability of these parties to translate policy preferences into action, however, varies across the two countries. "In Germany, the alternation of party control – between the Social Democrats and the Christian Democrats – has exercised little effect on the course of monetary policy. In France, by contrast, a similar alternation of parties has produced a very substantial impact" (Goodman 1992: 213). In this sense, Cukierman claims that any administration, whether liberal/leftist or conservative, will raise the rate of monetary expansion when it expects real economic activity to be relatively low, which

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resources among competing uses. These preferential credit schemes constitute the central questions for politicians during industrialization.

suggests that monetary policy varies according to administrations rather than partisan affiliations (Cukierman 1992).

Bernhard also shows that there is no statistically significant relationship between partisan ideology and CBI. Instead, he points out a counterintuitive argument that leftist parties will favor independent central banks. Leftist parties recognize that they have little inflation-fighting credibility with financial and capital markets, which contributes to higher risk premia and the possibility of capital flight. To demonstrate their commitment to responsible economic policies, leftist parties may establish an independent central bank. Rightist parties have more credibility in the markets and, consequently, less incentive to choose an independent central bank. This is why Thatcher's government never moved to grant the Bank of England more independence, whereas the Labor Party decided to give more independent monetary and financial authority to the bank in 1997 in order to appeal to both markets and their more moderate constituencies (Bernhard 1998).

In my perspective, the partisan affiliation story is another version of social group theory, which suggests that leftist politicians work for organized workers while rightist politicians work for capitalist classes. Assuming that the Phillips curve (i.e., the tradeoff between inflation and unemployment) dictates the market, the theory asserts that a rightist government prefers to favor its social base, capitalists, by stabilizing the price level and thus high favors a level of CBI, while a left-wing government wants to support the unionized workers by boosting economic transactions so as to lower unemployment rates and thus raises the level of CBI. Lurking behind the partisan affiliation theory are various social groups' interests and preferences.

It should be noted that social groups' preferences are not fixed and homogenous as the simplistic theory assumes. Industrialists and financiers, two major social bases of rightist government, may have different preferences toward the price stability since the former, as debtors, may not be as resistant to inflation as the latter as creditors. In addition, organized workers – supporters of leftist politicians – may sometimes have the same preferences and interests as industrialists – social bases of rightist government – by whom they are employed, since rank-and-filers' material benefits often depend on the profitability of the industry that they are in.

Political Business Cycle and CBI

A group of political economists have focused on the impact of periodic elections on economic policy choices in democracies. They argue that a government, whether rightist or leftist, chooses economic policies to maximize its plurality in the next election. Thus, as an election approaches, opportunistic and self-interested incumbent officials manipulate the economy to gather votes: the unemployment rate will be lowered and the economy will expand. But, immediately after an election, the victor will raise unemployment rates to a relatively higher level in order to combat inflation caused by their own or predecessor's pre-election policy exploitation. This is a political business cycle (PBC), with unemployment and deflation in early years followed by an inflationary boom as an election approaches (Nordhaus 1975).

The PBC explanation offers insights into the relationship between democratic political competition and CBI but, if the PBC theory is correct, one should empirically see a strong correlation between inflation rates and the timing of a move to CBI. Unfortunately, an empirical study shows that there is no such correlation (McNamara and Castro 2003).

Given that a central bank is a government institution whose major goal is to fight inflation, the political business cycle implies that the CBI will fluctuate according to electoral cycles. As election time comes near, any election-motivated governments, rightist or leftist, will deny their central banks inflation-fighting authority and provide easy money to boost the economy. In contrast, after an election, any winner – leftist or rightist – will support the CBI so to lower high inflation, thus increasing the unemployment rate. CBI as an institutional phenomenon, however, does not fluctuate to the rhythm of election schedules; it does not change as frequently and periodically as elections happen. Rather, one often sees an institutional inertia once a level of CBI is established.

One of the behind-the-scene assumptions of the PBC theory is that it is based on a model of "myopic" voters who quickly forget what governments did when facing electoral competition. The story is totally different if one considers "far-sighted" rational citizens who remember what the government did in the past and accordingly can predict what it will do in the future. For example, as elections repeat periodically, organized workers may not vote for an employment-enhancing government just because they expect that government officials will focus on economic stability thus allowing high unemployment rates after they win the election. Likewise, financiers will not always vote or contribute campaign funds for the opportunistic government since they know they will suffer from price instability and high inflation rates as elections come near. Opportunistic manipulation of the economy based on myopic agents is sometimes effective, but will ultimately fail.

The fact that the CBI has a certain institutional inertia surviving recurrent elections suggests that there is a relatively solid relationship between government politicians and their key social groups, which is not subject to election-motivated opportunism. Governments usually have social bases which politicians rely on for their political welfare. Therefore, they will rely on core social groups to decide important economic policies including CBI. If they keep switching over to the opposite policies before or after elections, their key social group will withdraw its political support and loyalty.

Tenure Security and CBI

Based on his research on the Deutsche Bundesbank, Bank of Italy, and Bank of France, Goodman claims that a government which has a preference for low inflation and expects a short tenure will adopt an independent central bank to limit the ability of future governments to manipulate economic policy (Goodman 1991). Applying this tenure security problem over time to the Chilean case, Boylan brings up the fact that exiting Chilean government officials spearheaded the central bank reform in 1989. Her story is that "outgoing authoritarians seek to protect their interests by increasing the autonomy of the central bank that would otherwise be subject to the vicissitudes of the democratic political process" (Boylan 1998: 444). Intensity and proximity of the political threat by democratic forces contributes to authoritarians' efforts to create an independent central bank.

The "tying successor's hands" theory argues that a government's tenure security problems cause the rise and decline of monetary authorities' independence, although there is not much agreement in the field. Clark finds that tenure security or insecurity, measured by the size of the governing party's majority or plurality in the legislature, bears no statistically significant relationship to CBI in developing countries (Clark 1994).

An implication of the 'tying successor's hands' theory is that highly polarized systems or systems with highly antagonistic parties should have independent central banks. Systems with moderate, centrist parties should have dependent banks, since politicians can trust the opposition to pursue similar policies to their own. Bernhard shows that this is not the case. Broadly based, moderate/leftist parties and low levels of polarization are associated with high levels of CBI (Bernhard 1998).

In addition, the theory hints that governments with tenure security may be expected to have dependent central banks, because they do not face any serious political challengers. But there are many cases that do not reflect this. For example, the KMT and PRI governments ruled Taiwan and Mexico, respectively, for a long time but they devolved institutional autonomy to central bankers when they could have kept them in tight control under the finance ministry (Cheng 1993; Maxfield 1991).

The theory also implies that the outgoing government will choose to reduce CBI in a reversed sequence of leftist-to-rightist, or democratic-to-authoritarian transition. If this is the case, the tenure security theory approaches the aforementioned partisan affiliation theory: a leftist or democratic government will pursue their preference "to the last day of its governing period" manipulating the central banking system so as to benefit its own politicians and social bases.

Interestingly enough, the theory regards the former government as a reformer for CBI in a sequence of rightist-to-leftist or authoritarian-to-democratic transition. But an incoming government may also assume the role of reformer. Regardless of a government's partisan affiliation, newly elected officials may support CBI to fight inflation as they learn from the former government's failure to keep inflation within tolerable boundaries. As Karen Remmer argues, it is more common that crisis-stricken precedent governments are followed by reformer governments than vice versa (Remmer 1998; Rodrik 1994).

Governments' Financial Needs and CBI

The last type of government-sided CBI story considers the correlation between governmental financial needs and CBI. According to Broz, severe budget deficits incurred by a government create an incentive for politicians to support CBI to attract financial resources to fund the deficits. For example, in the case of the Bank of England, repeated violations of government loan contracts by monarchs severely constrained the creditworthiness of the English state. Creditors were very concerned about extending loans to the government when the war with France required a great amount of governmental expenditures. In 1694, Parliament accepted the plan for a Bank of England proposed by London creditors. The state received badly needed loans in exchange for granting extensive legal privileges to a private banking corporation (Broz 1998).

The United States is another instance of the "government financial needs" theory. Early central banking arose during the War of Independence that led to the government's war deficits. The fledging government undermined the sanctity of its debt obligations, which resulted in the loss of the government's credibility in the eyes of creditors. The government promised rents on financial transactions to a special bank (The First Bank of the United States) by granting it a monopoly, in exchange for restoring public confidence in lending to the government (Broz 1998).

In the same vein, Maxfield argues that the founding and bolstering of central banks appears to come in waves associated with periods when foreign capital inflows are highly prized and the leverage of international creditors and their domestic allies rises commensurably. The more internationally integrated the economy, the more likely it is that a government's need for financial assistance will yield CBI, because "foreign investors read central bank independence as a signal of the strength of domestic proponents of sound monetary policy, both within the government and among domestic social groups, with whom the investors might implicitly or explicitly ally in an effort to influence policy" (Maxfield 1997:36).

The "financial needs" explanation does not explain why a government delegates financial power to a central bank in order to draw private capital when there are a variety of other ways for financial mobilization. A government in debt can mobilize resources by increasing taxes, printing money, cutting back the budget, and issuing bonds. When determining how to collect money, governments may consider their social bases of support to minimize disadvantages that may befall their constituents. For example, governments tend to rely, *ceteris paribus*, more heavily on seigniorage revenues to bridge temporary discrepancies between expenditures and revenues if elected officials' coalitional bases are industrialists who are often debtors of private commercial banks. Since inflation favors debtors over creditors, officials and industrialists often have an incentive to partially default on and inflate away their debt burden through inflation. Thus they may prefer relatively dependent central banks subject to political pressures. In other words, a government's financial needs do not always lead to higher CBI; rather the opposite case often occurs.

In sum, government-sided theories emphasize some political conditions under which CBI delegation occurs, bringing up partisan affiliation, the political business cycle, tenure security, and a government's financial needs. But the theories do not take into full account a 'problem of mobilizing support.' Deciding on delegating monetary and financial powers to a third party, politicians need to find support for their choice from a number of societal actors if their choice is to be sustainable and acceptable.

III. Society-Sided Theories of Central Bank Independence

Some studies of the sources of CBI focus on the organizational and political strength of different sectoral/interest groups with different relative preferences for employment and price stability. Posen argues that financial firms tend to be very supportive of monetary restriction and price stability, favoring the CBI (Posen 1995). On the other hand, William Clark claims that capital-intensive industries tend to prefer dependent central banks since they are capital-hungry and thus prefer cheap credits manipulated by the government.

In a way, the aforementioned anti-CBI scholars also emphasize social groups' preferences toward the central bankers' autonomy. When they criticize the central bankers for their functioning as the executive committee of the capitalist class, Magdoff and Sweezy argue that the capitalists prefer an independent central banking system (Magdoff and Sweezy 1987). In the same vein, criticizing the U.S. Federal Reserve system, Greider agrees with Posen insisting that the holders of financial capital prefer CBI (Greider 1987: 11-12).

Society-sided theories contribute to the political economy of the CBI by looking into the social interests that the government-sided perspective pays insufficient attention to. Those theories show that, even if elected officials seem to decide on the CBI for their own interests, lurking behind the officials' decision are social interests which supply their political welfare.

Society-oriented theories have some shortcomings in examining sources of varying degrees of CBI. First, most studies focus on big industrialists and financiers, paying little attention to subordinate social groups such as workers, farmers, and small and medium-sized enterprises (SMEs). This bias originated from the notion that big industrial and finance firms are more organized and have more intense preferences toward the CBI than the subordinate groups. But it should be noted that those subordinate groups may be minorities in the market, although they are a majority as citizen-voters in the political realm. In other words, self-interested politicians who mobilize support from social groups may co-opt or integrate those subordinate groups into the political system to strengthen their power bases. In this case, government politicians will not do exactly what the big firms want them to do, since they have to accommodate and satisfy heterogeneous interests – subordinate groups and the big firms – at the same time. Big industries and financiers' power to secure what they want is not only a function of their own sectoral influences but also a function of the power of countervailing groups.

For example, there are *jituanquye* (big business group) in Taiwan. In theory they are expected to exert a great deal of influence on the government's monetary and financial policies since they are organized and influential in the market. In practice, they are not as powerful as the society-oriented theory predicts, for the Nationalist government traditionally adopted pro-SME policies discouraging the development of the big bourgeoisie.

Capital-intensive industry in Singapore tells the same story. The Singaporean government employed a state-guided industrialization and nurtured big industrialists for rapid economic growth. This suggests that capital-intensive industries in the entrepôt have political leverage with which they can pressure the government to do what they want it to do. In reality, the picture is totally different. The government has adopted labor policies to integrate organized workers into the political system so it could not support big business at the costs of organized labor. Elected officials have to take care of both groups and workers check and balance capital-intensive industrialists' desires.

Second, some sectoral group-oriented explanations assume that sectoral or interest groups should have political influences in exact proportion to their economic competitiveness. The more competitive a sector is, the more likely it is to gain political power. This means that the explanations register a pluralist assumption that preferences are the same as the policy outcome, ignoring political selection mechanisms involved in translating a potential alliance of interest into actual policy benefits. In a nutshell, the sectoral/interest group explanation essentially posits that CBI is an epiphenomenon of societal forces, and assumes that politicians bear neither costs nor benefits from having either a dependent or independent central banking system. Thus, the pluralist story does not answer which party the government will favor when it faces equally powerful anti-CBI industrial and pro-CBI financial sectors. The government may tip the balance toward the former or the latter pursuing its coalitional partners' preferences.

Third, interest groups' preferences may not be fixed as society-sided explanations assume. Exogenous economic events – particularly a large and rapid inflationary upswing – can lead non-financial actors to redefine their interests. Goodman (1991: 333) offers a possibility that industrialists may support CBI.

> In a period of rapid inflation, many manufacturing firms, for example, will become less concerned about the prospects of deflation and more worried by the increase in their real tax burdens and the erosion of their financial holdings. Under these circumstances, they will be less inclined to oppose initiatives in favor of CBI.

Furthermore, industrialists may be less concerned about CBI if they can freely attract foreign loans to fund their business operations without institutionalized intermediation from the state. This "financing by bypassing the state" is a typical phenomenon in Thailand where the manufacturing sector does not care much about CBI even if central bankers in Bangkok do not extend cheap credits to industries keeping strict monetary policy.

In the same vein, Hall and Franzese claim that strong labor and industry can be helpful for CBI and price stability if corporatist institutions exist. “Where wage bargaining is more coordinated, the signaling process between the central bank and economic actors is likely to be more effective, so that increasing CBI can lower the long-run rate of inflation with relatively low unemployment costs” (Hall and Franzese 1998: 506). In sum, interest groups’ preferences are subject to change.

According to Posen’s theory, financiers and bankers are expected to pressure governments to provide institutional autonomy to central bankers who will enhance financial sector’s interests. But situated in different politico-economic conditions, the same the financial sector will be different in their preferences toward the CBI. For example, commercial banks, although owned by the KMT government, have consistent and strong preferences for a powerful central bank since they cherish monetary and financial stability. In contrast, commercial banks in Korea do not have as strong and consistent preference for CBI as their Taiwan counterparts even if they are private capital. The reason is that the financial sector, especially in the 1980s and 1990s, was owned and controlled by chaebols (big business conglomerates) so the sector represents big industrialists’ preferences toward the CBI. The Korean financial sector has not argued for an autonomous central bank in Seoul.

Fourth, sectoral group-oriented scholars have not reached an agreement about which groups have preferences for and against the CBI. Posen argues that the financial sector is the most consistent CBI supporter since it flourishes with independent central bankers on macroeconomic issues. In contrast, Frieden argues that holders of liquid assets are indifferent to governmental policy including the CBI problem, for they can switch their funds over to alternative business that can earn high rates of return (Frieden 1991:21).

Another disagreement in the field is about industrialists’ CBI preferences. The basic assumption is that sectoral groups’ preferences for macroeconomic policies translate into preferences for the CBI. Groups favoring price stability will also favor the CBI while groups preferring full employment will argue for political control of the central bankers. Thus Maxfield argues that labor-intensive industry is the most likely to oppose the CBI (Maxfield 1997:22). In contrast, Clark argues that capital-intensive industry poses the greatest challenge to central bankers' authority (Clark 1994: 124). Labor-intensive industry is usually located in light industry and SMEs while capital-intensive industry is mainly found in heavy and chemical industries and big firms. Further research is needed to clarify the aforementioned disagreement in the filed.

Central Bankers' Capacity and CBI

Lastly, an explanation of the sources of CBI takes into account central bankers' leadership and Weberian bureaucratic rationality (Hamilton-Hart 2002). If a central bank has a high quality of expertise as well as an impersonal and rule-based form of organization under the leadership of the central bank governor, it is likely that the government will trust the central bankers' capacity to manage monetary and financial policies and thus allow CBI. Furthermore, central bankers of this type will be able to fend off government pressures once they achieve CBI.

Although this explanation claims internal attributes of a central bank itself as a CBI source, the governor's leadership may be a result from a government's commitment not to intervene in central bank operations, for it is often the case that even experienced and knowledgeable central bankers are forced to be subservient to the finance ministry and spending agencies. Government politicians and technocrats may oust capable but disobedient central bankers, which leads to a dependent central banking system. On the other hand, central bankers' leadership and expertise may be based on followers' willingness to accept the bankers' guide, advice, orders, and instructions. In other words central bankers' leadership is a function of the financial community's preferences and its acceptance. Even if central bankers are effective in managing their own business, commercial bankers and financiers may often resist them and not respect "the bank of banks." In sum, politicians' motives and the financial sectors' self-interested willingness may lurk behind the ability of central bankers to exercise leadership.

IV. The Arguments: Coalition Politics of Central Banking System

In this section, I propose to focus on the different coalitional bases of varying levels of the CBI to explain why some central bankers have independent regulatory authority that contributes to their stable monetary and financial regimes while others do not. First, let me start with the inflation problem, since monetary control/stabilization is a major policy goal of central bankers.

How does price instability and inflation affect the economy in a society? The accepted view is that "in the longer term this relationship is negative, i.e., more inflation is associated with lower growth of output. The deleterious effects of hyper-inflation on growth, with the dislocations caused to saving patterns and to the monetary and pricing mechanism, are fairly obvious" (Fry, Goodhart, and Almeida 1996: 14).

There are a variety of channels though which inflation may adversely affect real activity and output. First, if a tax system is not fully indexed to price changes, a high inflation tax of nominal interest earnings may seriously distort the incentives to save and invest. Second, a higher level of inflation is often associated with higher volatility of price levels, increasing economic uncertainty in a society. In response, economic actors will be unwilling to make long-term commitments to any business activities, which can severely decrease investment – a major source of capitalist economic growth. Furthermore, it is difficult for actors to perceive and to react to changes in relative prices. These noisy and inconsistent price signals may cause an inefficient allocation of economic resources (Fischer 1994).

It should be noted that inflation has uneven effects on various social interest groups. Roughly speaking, "financial firms tend to be very supportive of monetary restriction and price stability while workers, manufacturers, and farmers tend to favor greater expansion since they prefer full employment and prosper less in periods of deflation" (Goodman 1991: 333). Therefore when inflation happens, various sectoral groups will bring different and crosscutting pressures to bear on the government.

On the other hand, politicians choose their coalition partners among various groups/sectors that maximize their political welfare. In other words, the policymakers maximize their political survival by playing the political gains in one sector against the political losses in the other sectors. In this sense, government officials consider their coalition bases and thus their political survival when they deal with the CBI problem, a critical issue for them in allocating financial resources to their favored political partners. Thus CBI is a function of the political costs and benefits political leaders associate with different coalition types. In other words, social groups, as far as they are in the coalition, can influence the government to do what they favor.

How does this coalition type shape the central banking system? I pose two arguments, accompanied by theoretical explanations.

Hypothesis 1: if politicians choose capital-intensive industry and/or organized labor as their major coalition partners, they will not allow central bankers to have an independent authority.

I generate a rough picture of capital-intensive industry's interests on the basis of deductive logic. According to Frieden (1991:19-20), an economic agent's interest depends on asset specificity:

> An actor's policy preferences are a function of the degree to which his asset has an available alternative use in which it earns a similar rate of return. The harder it is to move an asset from use to use, the more closely its owner is wedded to its current activity and the greater the incentive to obtain policies to favor this activity.

Specific asset-holders are more susceptible to a government's economic policy changes and thus have more incentives to lobby for their desired policy. Capital-intensive sectors, such as electronic, metal, heavy, and chemical industries register high asset specificity. Capital-intensive sectors are characterized by unique technology, dense business network, high rates of industrial concentration, "high barriers to entry, large economies of scale, and huge sunk costs in task specific fixed capital" (Clark 1994: 77). These features contribute to a few firms' dominance of the capital-intensive sector, and they are in better a position to overcome the collective action problem in lobbying government policy in their favor.

Furthermore, in most developing countries, capital is scarce and long-term capital markets are underdeveloped, if they exist at all. Thus the manufacturing sector is usually a debtor that borrows the capital they need from public and private financiers, i.e., the government and commercial banks. Since theoretically high inflation favors debtors over creditors, industry will derive more value from government-induced favorable price changes than creditors.

The aforementioned theories suggest that if politicians choose capital-intensive industries as coalition partners for economic growth, one would expect an increased demand for subsidized credit, economic intervention, and laxness of monetary policy, as opposed to the central bankers' preference for tight monetary control and regulation of preferential credits.

As I stated in the literature review section, there is no agreement on which fraction of industry – capital-intensive or labor-intensive – is the strongest challenger to CBI in developing countries (Clark 1994; Maxfield 1997). I'll test this disagreement by using case studies of Taiwan and Korea, and statistical analyses.

As for organized labor, I expect that the strength of unionized workers is negatively correlated with CBI, but that their preference is weak. Their "weak" preference comes from the fact that workers have conflicting double positions with regard to the price stability that central bankers have as their main policy goal. As employed producers, they get benefits from nominal wage increases and price increases of the products that they produce, although as consumers they prefer price stability. Cross-cutting interests reduce the intensity of their preference.

Organized workers have preferences against CBI. First, as collective action theory suggests (Olson 1965), workers are likely to organize themselves to protect their benefits more as producers and wage-earners than as consumers. Producers and employees usually have a single income source so they organize very well, while consumers spend their money on a variety of commodities in the market so they find it difficult to organize against rising prices of each commodity. Second, the cost of tight monetary policies and austere measures such as cuts in subsidies tends to be felt immediately, while the benefits from price stability are usually socially diffuse and temporally distant. Third, unionized workers are usually found in the capital-intensive sector and their material welfare often depends on the profitability of the sector, which suggests that they will have the same negative preference with regard to CBI.

It should be noted that only when capital-intensive industrialists and organized workers are in the coalition with the government does their preferences translate into actual governmental policies. If they are out of the coalition, the government will pay little attention to their preferences and interests and their voices will not be heard.

My second hypothesis introduces social actors whose preferences contribute to central bankers' independent authority managing monetary and financial policies.

Hypothesis 2: If politicians choose other groups as their coalition partners (i.e., commercial banks, agriculture, and/or small-medium sized enterprises), they will be more likely to provide central bankers with independent authority.

The ability of capital-intensive industry to secure preferential credits and loose monetary policy is not only a function of its preference intensity and organization, but will also depend on the power of countervailing groups. Financial assets are the least specific of all assets since they can be moved to their most efficient allocation at relatively low cost. Therefore, as discussed in the previous section, financial asset holders may have fewer incentives to organize to influence sector-specific policies or relative price changes.

However, if the price level is uncertain and relative price changes are volatile, it is very difficult for financiers to know which sector is worth investing in. In other words, even if financial assets are liquid, it is not easy for the holders to find alternative business to invest in under the conditions of high and volatile price change. Therefore, financial asset holders will be interested in shaping "policy to the extent that it affects the return on financial assets in general; they are quite susceptible to changes in general price level. To the extent that they will mobilize to affect policy, therefore, financial asset-holders are likely to lobby for price stability and low inflation" (Frieden 1991: 21). In addition, rising and volatile price levels are the bête noire in the eyes of private financial sector since, by definition, inflation favors debtors over creditors.

Therefore, since a central bank, as the bank of private banks, tends to favor restrictive monetary policy and fiscal conservatism, governments allied with commercial bankers should be different from governments allied with capital-intensive industry.

Small and medium-sized enterprises (SMEs) may favor cheap credits and loose monetary controls by central bankers. In this sense, Maxfield claims that labor-intensive firms, a typical type in the SME sector, are likely to oppose the CBI (1997:22). Their preferences are, however, inconsistent and less intense compared to capital-intensive industries since the SMEs' assets are usually smaller and less specific than their capital-intensive big firms. In other words, the SME sector registers low entry and exit barriers, which suggests that they have less incentive to lobby the government for the policy they prefer. Furthermore, the SME sector is usually more dispersed and has a large number of unit firms, thus often suffers from the free rider problem; their organization costs are higher than those of their capital-intensive counterparts.

On the other hand, even if they prefer cheap credits, they often find themselves competing with capital-intensive big firms for a limited amount of financial resources. This competition between both sectors may make the SMEs show the cold shoulder to big firms in lobbying for the government. In addition, if the government elites invite the SME sector, rather than big business, into their social coalition, SMEs' preferences may be differentiated from those of capital-intensive big businesses. They may be less reluctant and more ready to accept CBI.

Farmers as producers may prefer cheap credit and loose monetary policy, but they have crosscutting interests: farmers may prefer instable and rising price levels as consumers of city-produced commodities. On the other hand, farmers do not always prefer loose monetary policies; rather, sometimes they prefer price stability even as producers. Features of agricultural production and marketing make them stand against monetary instability. They usually invest year-around, but reap a harvest few times a year so they have to wait for a long time to gain income from agricultural marketing and sales. This differentiates them from workers, who usually earn their income once a month, and industrialists, who can check their profits almost everyday. Furthermore, agricultural business is usually under the unavoidable control of capricious weather and seasonal conditions, thus the amount and quality of farmers' output is usually unpredictable at the time when they start farming activities. This intrinsic instability and inconsistency of their business operations often makes them prefer stable, predictable, and consistent levels of price so that they can run their businesses in more stable and predictable ways. In sum, farmers as both consumers and producers have reasons to prefer the monetary stability that central bankers pursue. Figure 1-1 simplifies the aforementioned spectrum of various sectoral groups' varying preferences with regard to price stability.

How does a coalition of countervailing groups whose interests and preferences are cross-cutting and heterogeneous contribute to an independent central banking system? First, siding with a special interest becomes costlier as the number of coalition partners increases. If the political coalition includes various participants, there would be "checks and balances" among heterogeneous and even conflicting preferences for government financial and monetary policies, and thus less pressure from capital-intensive industries for a dependent central bank. Furthermore, the checks and balances mechanism may inhibit the ability of political decision makers to reverse or undo central bank decisions. Evans (1997:83) once emphasized that political integration of various groups strengthens public-private relations:

> The central issue in recapturing embedded autonomy is clear. The heart of the problem is finding a way to counterbalance the weight of a more powerful business community so that embeddedness is less likely to degenerate into capture. At least one logical possibility presents itself. Extending the institutionalized connectedness that characterizes government-business relations under East Asian-style embedded autonomy to include a broader range of societal groups could potentially solidify the state's position and contribute to prospects for economic transformation. Comparative evidence suggests that including additional actors whose interests partially conflict with those of business in the institutionalized networks that bind state and society could strengthen the institutionalized character of business-government relations. Inclusion of groups with diverse and partially conflicting interests in public-private networks creates, as Biddle and Milor point out, strong pressures for transparency.

Second, governments with countervailing groups as their political constituency have incentives for CBI as a solution of distributive conflicts. In order to keep broad coalitions sustainable, governments have to satisfy or coordinate, in exchange for their broader political support, heterogeneous financial and monetary preferences from various groups, which is not an easy task. A solution is for the government to set up an institution that aims to control flows of money and maintain monetary and financial stability. The CBI will benefit elected officials, since they can avoid at least some of the blame for the conflicts by passing the buck to central bankers, and thus secure votes from their broader political constituency. The solution by delegation is an incentive for an independent central bank to rise as a macroeconomic regulator neutral to distributive politics. In this sense, CBI contributes to a government's political survival rather than hollowing out its ability to manage the economy.

V. Research Design

I will examine the aforementioned hypotheses in the following chapters by using 1) a focused comparison of two cases, i.e., Taiwan and Korea; 2) additional case studies of Singapore, Malaysia, and Thailand; and 3) a large-N statistical test of developing countries. This combination of three different and complementary methods is known as triangulation (Tarrow 1995), which is particularly appropriate in cases where quantitative data are partial and inconsistent, and qualitative investigation is obstructed by political conditions, as in the study of central banking systems and political coalitions.

Since there is no perfect method that guarantees the scientific causality in social science, it is appropriate to use varying methods to tackle the same question. "The case study method uncovers causal processes hitherto undetected, or leads to a reformulation of previously postulated causal processes… Focused case studies are particularly useful at an early stage of theory development, when considerations of theory development greatly outweigh those of testing." (George and McKeown 1985: 51-52). After comparing Taiwan's and Korea's political coalitions and central banking systems, I'll see whether or not my hypothesis holds in the East and South-East Asian context. I'll do additional case studies to probe into the generalizability of my arguments by asking if those patterns in the coalitional bases of the central banking system and CBI are observed in other cases. Finally, I'll employ a large-N statistical method for more a rigorous test of my hypothesis in the context of developing countries.

As for my case study selection, I employ the "most similar systems" or "method of difference"(Przeworski and Teune 1970) to identify independent variables associated with differing outcomes. I chose Taiwan and Korea because prominent explanations about central banking systems come mainly from Western industrialized countries rather than developing countries, and because these two countries are good cases since they share many similarities but differ in CBI and coalition type. The two countries are similar in terms of the historical experience of Japanese colonialism, successful land reform after World War II, their existence as divided nation-states, small open economies, state-driven and export-oriented industrialization, concurrent sequences of industrial development and democratization, and long experience of authoritarianism, as well as their subordinate relationships with the U.S. They differ in that the Korean central bank is dependent on planning and spending government agencies and has low autonomy, while the central bankers in Taiwan are not subject to political pressures and keep monetary stability and financial prudence as their goals. The "most similar systems" method is useful for controlling the variables that might otherwise affect outcomes on the dependent variables.

The research of this study involves field work in Seoul, Korea and Taipei, Taiwan, including interviews and archival research. In the cases of Singapore, Malaysia, and Thailand, I used secondary literature, newspaper clippings, official periodicals issued from central banks, and email interviews with central bank officials. As for the scope of the research, my study focuses on the correlation between the coalitional composition of national government (i.e., the independent variable) and the different levels of CBI (i.e., the dependent variable) from the 1950s to the 1990s.

VI. Conclusion

My research starts from the diverging experience of two Asian NICs, Taiwan and Korea, in the turmoil of the Asian financial crisis in 1997. Why did Taiwan survive the crisis while Korea faltered, when they share many similarities? Theoretically, my research question explores the uneven development of central banks' independent authority: why do some central bankers have autonomous power that contributes to their monetary and financial stability, while others do not? There have been many prominent explanations of the phenomenon, including government-sided theories (i.e., partisan affiliation, political business cycle, tenure security, and government financial needs) and society-sided theories based on interest groups as well as the internal attributes of central banks.

While this study uses some insights from both sides, it also challenges certain aspects of them. Government-sided theories pay little attention to the social bases of central banking and domestic financial systems. Society-sided theories are useful for understanding the array of social forces, but are less clear about the political selection mechanisms through which some interests come to be favored by their government. My study starts from society-sided sectoral/interest groups, but at the same time incorporates politics. It is a politically reconstructed explanation of the social bases of CBI. The dissertation explores governments' coalition partners, and how this affects CBI and thus monetary and financial regimes.

The remainder of this dissertation unfolds as follows. Chapter 2 discusses the political choices about coalition-building that Korean and Taiwanese elites made to secure their political survival. Chapter 3 analyzes social bases of the two countries' economic growth, focusing on heavy-chemical industry, SMEs, organized labor, farmers, and the financial sector. Chapter 4 compares central banking systems in Korea and Taiwan, discussing how and why different political leadership's coalitional choices shaped different central banking systems in those two industrial rivals in East Asia. Chapter 5 surveys additional cases (i.e., Singapore, Malaysia, Thailand) to see if the configuration of coalitional bases and CBI is found in the Southeast Asian context. Chapter 6 tests the hypotheses of the study by using statistical analyses of central banking systems in 36 developing countries. Chapter 7 concludes with a summary of the main findings of my study and discusses their theoretical implications as well as limitations.

Chapter 2: Choosing Developmental Coalition Partners

This chapter explains how and why two Asian NICs, Korea and Taiwan, were different in inviting various social groups into their developmental coalition. The next chapter will go further in detail comparing both countries' sector-by-sector politics of developmental coalition-making.

In the first section of the current chapter, I describe the prehistory of developmental governments in Korea and Taiwan and how those governments reached policy agreements with the U.S. I argue that the setting up of developmentalism in Korea was not smooth due to policy conflicts with the U.S. that lasted until the 1960s, when the Park government started export-oriented industrialization, gaining policy rapprochement with the American hegemon. In contrast, the Kuomintang (The Nationalist Party, KMT) government adopted a "growth with stability" principle, mainly due to historical learning from the failure in mainland China, reaching policy agreement with the U.S. earlier than Korea.

The second section discusses how political leaderships in Korea and Taiwan differed in pushing economic growth for their political survival, with reference to private businesses, state agencies, and party-legislative politics. The political leadership in Korea made a developmental coalition with big business and adopted an unbalanced growth-oriented strategy, while the KMT government set up the coalition without the private big bourgeoisie, espousing a balanced, stability-oriented approach to industrialization. The last section summarizes my conclusions based on the two case studies in the chapter.

I. Narrowing Down Policy Choices toward Export-Oriented Industrialization

Korea: Policy Disagreement and Rapprochement with the U.S. Hegemon

The developmental coalition in Korea can be classified as growth-oriented. A growth-oriented coalition pursues rapid growth at almost any cost, including high inflation, regional and sectoral imbalances, or disproportionate concentrations of wealth. The coalition usually chooses "unbalanced" modernization strategies by which, in situations of economic backwardness, concentrates scarce government-controlled capital and resources into strategically chosen industries (Park 2001).[2]

But the growth-oriented developmental strategy of Korea was not established from independence from Japanese colonial rule (1910-1945), or even the early stage of General Park Chung Hee's military regime (1961-1979). "The course of development was shaped more by numerous improvised decisions or ad hoc policy changes than by some premeditated national grand design. And the process was replete with political battle" (Cheng 1990: 141).

The United States Army occupied Korea from 1945 to 1948 and played a major role in building institutions, limiting what was possible by manipulating their aid to resource-scarce Korea. The U.S. aid was actually a lifeline for Korea, then a poor post-colonial agrarian society. Between 1953 and 1961, U.S. aid accounted for nearly 70 percent of total imports and 75 percent of total fixed capital formation (Cole 1980). Furthermore, the amount of the aid was tremendous since a "free" Korea was an important strategic post against the communist bloc consisting of North Korea, communist China, and the Soviet Union. "Korea's total of nearly $6 billion in U.S. economic grants and loans, 1946 to 1978, compares with a total for all of Africa of $6.89 billion and for all of Latin America of $14.8 billion; only India, with a population seventeen times that of Korea, received more ($9.6 billion)" (Cumings 1987: 67).

However there were policy disagreements over the use of the U.S. aid program among American policy makers, the military, and the State Department (Lyons 1961: 6). Haggard, Kim, and Moon (1991:852) describe the policy disagreements as follows:

> The American-dominated UN leadership was highly skeptical of Korea's economic potential and was primarily concerned with buttressing Korea's military position rather than its economic self-sufficiency. The American military emphasized stabilization, arguing strenuously about the dangers of credit expansion and new industrial investments. On the other hand, an economic advisory team to the United Nations Korean Reconstruction Agency (UNKRA) and Economic Cooperation Administration (ECA) supported by the State Department represented a more liberal

[2] For "balanced" and "unbalanced" economic development, see Albert Hirschman, 1958, *The Strategy of Economic Development*, New Haven: Yale University Press.

> developmentalist approach that was critical of the stabilization package. This group argued for a rationalized program of infrastructural development and import-substitution industrialization (ISI) that would make Korea self-reliant in five years, financed by large infusions of development assistance and greatly expanded mineral and agricultural exports.

President Rhee Syngman (1948 – 1960) found space for maneuverability in the aforementioned two U.S. policy options toward Korea, playing one against the other. Rhee, a Princeton Ph.D. in government under Prof. Woodrow Wilson, was skillful at manipulating the bureaucratic compartmentalization within the U.S. government; he was "effective in playing off the Defense Department against the U.S. Agency for International Development (USAID) and the State Department"(Woo 1991: 9) For example, Rhee often frightened American foreign policy makers by threatening to blitzkrieg North Korea, so the U.S. maintained their troops in Korea as a force of military moderation. On the other hand, Rhee complained publicly about the U.S. government's slowness of aid delivery, their lack of attention to new investments, and overemphasis on commodity imports.

His trick worked in 1955 when the Rhee government and the U.S. State Department reached temporary agreement on economic reconstruction in Korea. Rhee promised inflation-fighting stabilization and devaluation in exchange for further U.S. aid, the material base for his political constituencies. The Rhee government was skillful as a "U.S. aid maximizer to overcome the scarcity of domestic resources" (Mason et al. 1980: 94) with no serious long-term vision for economic growth and industrialization as in the Nathan Plan that the UNKRA recommended (Jones and Sakong 1980: 44). Cole and Nam (1969: 32) argued that the 1950s leaders:

> rejected the idea of overall planning and were not interested in trying to define the longer-run economic objectives or an integrated set of policies. These probably reflected a belief on their part that they could retain more flexibility and achieve better results in negotiations with aid donors by proceeding on an ad hoc basis and avoiding the overall commitments and constrains of a plan. Clearly the Nathan Plan called for very forceful policy action by the Korean government and set ambitious targets of self-

> support which the Koreans were not prepared to accept. To have agreed to the plan would have exposed the government to serious political risks.

The stabilization program, however, did not work because the Rhee government was a corrupt rent seeker (Haggard 1990: 57). The government used policy instruments such as allocation of foreign exchange, bank credits, import licenses, and the privatization of state-owned enterprises to maintain its political support. Rent allocation was based on personal and political ties, and flowed to the highest bidders for political contributions. Furthermore, in 1954 the government rejected the Nathan Plan of liberal developmentalist version prepared by UNKRA, which shows Rhee's economic policy was a confusing patchwork, lacking long-term economic strategy. For example, when four ministers of economic affairs, impressed by India's economic efforts, proposed a five-year economic development plan in March 1957, Rhee reprimanded them for being affected by "Stalinist thinking of economy" (Lee 1993:54). The government lacked the political will for industrial transformation of the agrarian society.

After a series of student demonstrations against the corrupt government, Rhee resigned and the opposing Democratic Party came to power in 1960 in the form of a parliamentary system. The Chang Myon government (1960-61) tried some market-oriented economic reforms, including devaluation of foreign exchange and rationalization of state-owned enterprises that the U.S. had pursued during the 1950s. But the perpetual intra-party factional disputes prohibited the formulation and implementation of effective economic reform (Kim 1975: 207-209). Thus the US-Korea tug of war and policy disagreements over how to use U.S. aid and reconstruct the Korean economy lasted well into the early 1960s. Both the authoritarian Rhee government and the democratic Chang Myon government lacked the political will necessary for long term economic developments.

After the military coup of 1961, General Park Chung Hee and the military government centralized state power, holding the civil bureaucracy on a tight leash and began to recruit highly-trained academics to staff the newly created developmental headquarters – the Economic Planning Board (EPB). But the U.S. was quite suspicious of General Park since he had been a communist before the Korean War (1950-53).

Moreover, his early policy drive aimed at nationalistic import substitution industrialization (ISI). He argued in 1962 that the "creation of a self-supporting economy and accomplishment of an industrial revolution is a key to national renaissance and prosperity" (Park 1962: 171). The U.S. could accept his pledge of economic development, but the Americans endorsed a liberal version. In the American view of economic liberalism, export-oriented industrialization (EOI) was the most rational and promising strategy for small-sized, resource-poor, and labor-abundant economies.

An example of the U.S.-Korea policy conflicts was the currency reform that Park's military junta pushed in 1962 in the hope of mobilizing domestic financial resources into an industrialization fund. Citizens were required to register all cash, checks, and money orders, and to direct personal savings into a new Industrial Development Corporation that would finance industrial activities. U.S. officials were shocked by the blitzkrieg reform since it was initiated without prior consultation with the U.S. government. Faced with severe opposition from the American officials, the junta soon terminated the money squeezing measure (Tadashi 1991).

Cole and Lyman (1971: 165), American policy advisors, described the U.S.-Korean policy agreement over domestic resource mobilization as follows:

> As productivity of the Korean economy increased, the conflict of objectives between aid donor and recipient sharpened. The basic issue was over domestic resource mobilization, that is, over the share of the increasing output that should be saved or taxed to provide resources for investment, for the maintenance of military forces, and for other essential government services. This conflict had a major impact on the entire range of economic policies in Korea throughout the postwar period. Taking many forms, it at times had harmful effects on the political and economic development of the country. Unfortunately, quite often this issue was posed by both Korean and American officials, in terms of a direct conflict between domestic resource mobilization and foreign assistance.

Facing the American hegemon's opposition, the Park regime was quick to change its policy orientation to follow the course recommended by the U.S. It revised its original five year economic plan (FFYP, 1962-1966) that stressed inward-looking ISI deepening to achieve an integrated domestic industrial structure, a seeming retreat from international economy (Cole and Nam 1969). Now Park accepted export-oriented economic development as his industrialization strategy, which until today has never been questioned. Furthermore, the junta concluded a secret agreement with Japan in November 1962. The Korea-Japan diplomatic normalization symbolized the Park government's hope to utilize Japanese investment capital and, from the perspective of the U.S., complete the grand design for regional integration (i.e., the anticommunist bloc of U.S.-Japan-South Korea against North Korea-communist China-Soviet Union) (Woo 1991). After Park's victory in the 1963 presidential election, American policy makers were relieved to see the setup of an anticommunist, stable, and civilian form of government with political will for economic growth, the exact answer to political and economic objectives that the U.S. had in the Korean peninsula.

The U.S.-Korea rapprochement toward a growth-oriented strategy came to fruition in mid-1964 when there were important changes in the leadership of both the EPB and the USAID mission. In May 1964, Chang Key-young took charge of the EPB as a deputy prime minister. Under Chang, the stabilization program as an anti-inflation measure began to be subject to a more active growth and investment policy (Cole and Nam 1971: 87). His policy drive won the full support of the president who thought monetary expansion was tolerable in the name of industrial expansion.

On the other hand, the USAID signaled that it would take a more lenient view of plan-targets than the previous team had. Traditionally, the USAID emphasized a strict money supply based on a neo-classical premise. The new USAID team and David Cole, an economic advisor, believed that "it was counterproductive to push strict monetary targets while simultaneously undertaking difficult reforms of the fiscal and financial systems" (Haggard, Kim, and Moon 1991: 864). The USAID consented to a low exchange rate and cheap industrial credit for businesses and exports. But the consent was a tacit one. "The USAID team did not openly abandon the money supply targets of the 1964 stabilization program on the grounds that to do so would lessen U.S. bargaining power on the Korean peninsula" (Haggard, Kim, and Moon 1991: 864). The U.S. wanted to exert pressure and their bargaining power if Korea were subject to severe expanist ills like high inflation and financial crisis in the 1960s.

In summary, the Rhee government in the 1950s was concerned mainly about aid maximization but lacked the political will to achieve long-term economic growth, which resulted in policy disagreements with the U.S.'s, which pushed economic liberalism. After the short democratic episode in 1960-61, General Park's government tinkered with ISI deepening and then finally adopted the EOI strategy that the U.S. and the IMF had recommended. In response, the U.S. compromised its stern emphasis of macroeconomic stability, tolerating an industrialization strategy that might cause expansionist ills.

Taiwan: Historical Trauma and Early Adoption of Economic Stabilization

Chiang Kai-shek and his *Kuomintang* (the Nationalist Party, KMT) adopted macroeconomic stability as their policy core after their relocation to Taiwan in 1949. The KMT regime was successful in stabilization during the ISI stage of the 1950s and continuously pursued orthodox macroeconomic policies such as positive interest rates, cautious monetary policy, and a well balanced budget. Why did the KMT government push so early the economic orthodoxy against the mainstream of economic thinking in those days? Given that the government firmly controlled the island, if the government had wanted to, it could have poured preferential credits to private firms for rapid industrialization.

The KMT learned a lesson of economic stability from their historical trauma, i.e., defeat in the mainland China and retreat to the small island in 1949. Destruction from wars against the Chinese Communist Party and Japanese imperialism and the siphoning off of resources for war had disastrous effects on China, especially acute fiscal deficits and inflation spiral. The price index skyrocketed almost ten thousand times from 100 in 1937 to 10,340,000 in 1947. Government deficits increased about nine hundred times from 1,276 million CNC (Chinese National Currency) dollars in 1937 to 1,106,696 in 1945 (Chang 1958: 124, 372). The real value index of deposits in private banks nosedived from 100 in 1937 to 1 in 1945 (Chou 1963: 215). The inflationary spiral was a major cause of the downfall of the KMT and the victory of communists in civil war. The spiral undermined KMT's political legitimacy from the bottom and destroyed the Chinese economy.

Desperate and humiliated when crossing the Taiwan Strait, the KMT leadership was quick to realize that to resist the Communists effectively and strengthen the KMT's tenuous position on the island, the party had to be fundamentally reformed and the people of Taiwan given an incentive to support it. Unintentionally, the relocation to Taiwan contributed to the consolidation of Chiang's political leadership since only loyal KMT officials crossed the strait while corrupt bureaucrats scattered with their assets to Hong Kong, Southeast Asia, and the U.S. Furthermore, Chiang broke the intraparty factions that he believed had rent his mainland regime to communists, taking complete personal charge of the political realm (Gold 1986: 59).

The KMT mainlanders were worried about the possibility of peasant upheavals in the post-colonial island and thus pushed land reform during 1949-53, culminating in The Land to the Tiller Act of 1953. The reform was a "passive revolution" or "revolution from above"[3] that removed the indigenous traditional elites' power base and earned political legitimacy from indigenous Taiwanese. In addition to the KMT government's political need, there was also American pressure for land reform, as the there was in Korea and Japan under American Occupation. The Americans strongly urged the reform on the Nationalists and supplied experts, advice, and funds, all funneled through the Joint Commission on Rural Reconstruction (JCRR). The reform was a breakthrough in the post-colonial agrarian society; it allowed the émigré government to earn strong support from farmers, the majority of the island (Gold 1986: 58-59, 63).

Having learned from its failure in mainland China, the KMT launched an orthodox stabilization program in the late 1940s and early 1950s. The program included currency reforms, balanced budgets, and high "preferential" interest rates, as well as tight governmental controls over money supply and credit availability (Clark 1989). These stabilization policies proved to be highly successful. The chronic hyperinflation rate plummeted to 300 percent in 1950 and about 30 percent in 1951-2, and then averaged less than 10 percent for the rest of the 1950s. Real GDP growth rates during 1953-60 averaged 7.2 percent during 1953 to 60 (Council 1969).

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[3] The locus classicus for the concept of "revolution from above" and "passive revolution" is Gramsci (1971), Moore (1966), and Trimberger (1978).

Successful ISI in the 1950s, however, was not carried out in harmony. Among economic bureaucracy there was a conflict between "those who favored continued state dominance of the economy based on its ownership of confiscated Japanese enterprises, and those who advocated more range for a private sector. In the 1950s, to revive production, the more socialist- or statist-oriented cadres prevailed" (Gold 1986: 67). The former group claimed legitimacy of ISI based on the official state ideology of the founding father Sun Yat-sen, who had once argued "the state should lead in business enterprises and set up all kinds of productive machinery, which will be the property of the state" (Sun 1927: 442).

In 1957, however, when the problem of foreign exchange and trade became worse, there was a big policy battle among the KMT policy makers, which consequently resulted in EOI as the strategic model for the Taiwanese economy. Pang (1992: 175) summarizes the policy battle as follows:

> Their opinions went in two directions: 1) a conservative-interventionist ISI line, represented by Hsu Peh-yuan, minister of Finance, maintained that the existing system had a great deal to contribute to the stability of Taiwan's economy and that overemphasis on market mechanisms would hurt the growth of Taiwan's infant industries; 2) a liberal-reformist EOI line, represented by K.Y.Yin, secretary-general of the Economic Stabilization Board, contended that the existing system had triggered too many corrupt practices and too much inefficiency, which could only be remedied by a comprehensive and radical change.

The liberal-reformist line finally won the battle due to the support given by the KMT's leadership, especially Chiang and Ch'en Ch'eng, Vice President, as well as from influential scholars like T.C. Liu and S. C. Tsiang (Ho 1987: 243-5). Chiang's choice of economic liberalism aimed at developing Taiwan as a "showcase" of Chinese development under free economic institutions. It had powerful propaganda value in the ideological battle with Communist China. Given that the Mutual Defense Treaty of 1956 with the U.S. restrained the KMT government's bold military action to recover the mainland and offered military security for the island, the KMT elites saw economic development as "a means of increasing the probability of success in attaining the ultimate goal, return to the mainland" (Jacoby 1966: 37). In Gramsci's terms (1971: 238-9), the

KMT leadership changed from "war of maneuver" to the "war of position" vis-à-vis their lost mainland in late 1950, which was repeated in Korea when the Park regime put economic development over national unification on his agenda after his military coup.

The 1958-1960 economic reform package, including the 19-Point Program, liberalized exchange rates and controls on trade and industry, rationalized the fiscal system, reduced military spending, and enacted an investment promotion act. The government made the developmental strategy more export-oriented in 1965 by "adding more export and investment incentives into the statute as well as establishing the Kaohsiung Export Processing Zone" (Pang 1992: 191). The reform and subsequent measures constituted export-oriented industrialization as the main economic strategy – one that has not been questioned to date.

In addition to the KMT leadership's choice and academic persuasion, we must add American pressure to the list of explanations for the EOI transition. In the late 1950s, the U.S. Congress reviewed foreign aid policy, which resulted in a gradual emphasis on socio-economic development and fostering private enterprises and a market-oriented economy (Schelling 1957). On the island, the USAID mission often played the role of "whipping boy" for the development-minded officials in Taiwan. "The major weapon of USAID influence upon the KTM government was a promise to increase or a threat to reduce the level of aid. The government officials regarded the USAID policy advice as real, and the actions were in fact effective in producing desired results" (Jacoby 1966: 134). For example, in 1959, Director Haraldson of the USAID Mission proposed an 8-Point Program to the government that was later elaborated into the 19-Point Program through subsequent discussions with the KMT (Jacoby 1966: 134-5). The pay-off that the U.S. offered for the liberalization was more aid funds as well as introducing foreign direct investment (FDI) and financial capital from Japan and the U.S. to the island. Jacoby (1966: 130, 132), a USAID evaluator, commented on the USAID-Taiwan policy agreement and smooth EOI transition as follows:

> From the very beginning, the Chinese government and AID were involved by mutual agreement in an effort to use resources effectively for these purposes [stability and development]….The U.S. AID Mission had a strong, persistent, and generally beneficent influence upon the formation

> of Chinese economic policies…. The main reason for the large measure of U.S. influence on Chinese economic policy was that there was agreement between the governments of the two countries on fundamental aims. A broad set of mutual interests in military strength and economic progress were recognized. There was little debate over the basic framework of control of aid funds and Chinese resources…..The complementary interests of the two countries formed a firm foundation; disagreement could occur on the details of the superstructure.

In a political sense, the pro-EOI package was feasible, ironically, due to the Mission's failure to pressure the KMT to privatize the government sector. The package reform did not undermine state-owned enterprises (SOEs), the organizational base of the KMT government. Originally, USAID sought to persuade the KMT government to privatize the public enterprises in the banking, fertilizer, sugar, aluminum, iron, and steel industries, but the government was reluctant to follow the USAID advice (Jacoby 1966: 146-8). The government simply did not want to be shorn of authority over resource allocation. It is well to remember that in the 1950s almost two-thirds of all bank loans and discounts went to the government sector: on average 31.0% for government, 31.9% public enterprises, 28.8% private enterprises, and 4.5% individuals (Council 1969: 102). Politically, the government had to support its loyal state employees who crossed the Taiwan Strait with the KMT in 1949; financially, SOEs contributed to the émigré regime's control over the economy; and ideologically, KMT cherished a view of restraining private capital based on Sun Yat-sen's principle of *Minsheng* (people's livelihood). In a way, the EOI package was a policy compromise between American economic liberalism and the KMT's critical interest in political survival. As John Montgomery (1962) stressed, it is very important for a successful foreign aid policy that both the aiding and the aided governments respect a core of mutual interests and objectives. "The U.S. did not use economic assistance as a lever to bring about political reforms; the lever was used only to induce economic reforms" (Jacoby 1966: 148). The U.S. and the KMT agreed to push an EOI strategy but not to reduce the state's power to channel resources to SOEs.

So far I have discussed how the political leaderships of the two new nations narrowed down their economic choices under U.S. hegemony. In comparative perspective, both countries were deviant cases from most less developed countries that, with some natural resource base, tend to perpetuate ISI, a path of least resistance that avoids the pains of dismantling vested protected interests, especially agricultural and mineral export (Ranis 1977: 28-9, 31, 38, 42). In a nutshell, an easy and abrupt transition to EOI as a national strategy happened in the context of the Cold War milieu in which American hegemony cared about showcases of the free world, especially Taiwan and Korea "poised on the geopolitical fault line" (Woo 1991: 9).

II. The Politics of Making a Developmental Coalition

This section discusses how and why Korea and Taiwan accepted different developmental coalition strategies, the "unbalanced growth without economic stability" path in Korea and the "balanced growth with economic stability" path in Taiwan. Each government faced different political conditions. The key differences had to do with historical learning, political legitimatization, sub-ethnic cleavages, availability of industrialists, and the relationship between the ruling party and technocrats within each government.

Korea: Coalition with Big Business and Unbalanced Growth-Oriented Strategy

Since the Park government lacked the political legitimacy earned from democratic elections, it based its legitimacy on economic development that the preceding governments had failed to push. As Lucian Pye put it, "the criterion of legitimacy, to a dangerous degree, has become [a source of] success in advancing economic development. The more insecure the government, the greater the pressures on industry to expand. Any period of prolonged stagnation could cause a crisis of authority" (Pye 1988: 85). Explaining his military coup, Park argued "spiritually, this revolution must and will establish our self-respect. Socially, it is to modernize our society. Economically, it is to industrialize our nation" (Park 1962: 23). Among three modern projects (i.e., industrialization, state-building/national unification, and democratization), he emphasized the first even at the expense of the latter two when he said "development of democracy, construction of welfare state, and anti-communist national unification, everything depends on economic success" (Park 1969: 134).

As E. E. Schattschneider claimed, “new cleavage produces a new allocation of power” (Schattschneider 1960: 64). Park understood that the political actor who is able to define the issues prevails and is likely to take over the political realm, since the development of new cleavage (i.e., economic growth vs. underdevelopment) from old one (i.e., democracy vs. authoritarianism) is a prime instrument of power. An example of the political obsession with economic development is the growth rate that the first Five Year Economic Development Plan (FYP) targeted: the military junta ambitiously proposed 7.1% of economic growth rates compared to 1.9% of 1953-1960 average growth rates (Tadashi 1991: 49).

Now the real problem that the military government faced is “who will be the developmental agents that serve its economic legitimatization?” Landlords had already lost their material bases and disintegrated as a class due to successful land reforms under the Rhee government. The possibility of making a coalition with the popular sector including urban workers, farmers, and small business owners must have been thin since the government did not want to “waste” scarce material resources on such a “distributional coalition.”

But there were a few big industrialists available for the junta to choose from. In the 1950s under the Rhee government, big industrialists emerged through acquiring former Japanese properties at bargain prices and privileged access to U.S. aid, bank loans, and public contracts. Unlike the KMT that resisted U.S. pressure to privatize colonial-firm-turned SOEs, in 1947 the Rhee government privatized SOEs, as USAID recommended, to bidders with strong political ties. Favorable treatment from the state was possible only through political connections with the state elites. By means of these connections, the big bourgeoisie gained economic favors in exchange for political contributions. For example, “in 1960 the Industrial Bank issued a 4.3 million *won* bond to nine enterprises and got 1.7 million back from them as contributions for presidential campaigns” (Kim 1975: 152). However their clientelistic relations with the state elites created a politically weak and dependent bourgeoisie (Kim 1976: 466-9), different from idealized vision of the Western “conquering bourgeoisie” featuring moral and political leadership for an industrial society.

But it should be noted that the junta's choice of *chaebols* was not predetermined from the start of the military "revolution." In an apparent effort to ensure the legitimacy of the coup for the citizens, the populist military junta enacted the "Special Law for Dealing with Illicit Wealth Accumulation" to confiscate the industrialists' fortunes. The Special Law was intended to nationalize new industries, which could have led the Park regime toward the Taiwan model where the KMT government controls the majority of industries in the name of SOEs.

As the first FYP was initiated, however, the junta faced a dilemma of how to industrialize with the entrepreneurs who the Special Law targeted. Unfortunately, in the eyes of military leaderships, the bourgeoisie were the only viable economic force for the difficult task: they possessed entrepreneurial talents, organization, personnel, and capital resources. A deal was necessary. Thus the developmentalist EPB argued against their criminal prosecution, favoring political amnesty to the accused businessmen. General Park summoned the ten major business leaders and struck a deal with them, which resulted in the October 26 Decree:

> The government would exempt most businessmen from criminal prosecution; with the notable exception of commercial bank shares, existing assets would not be confiscated; and businessmen should instead pay off their assessed obligations by establishing new industrial firms and donating the shares to the government. (Jones and Sakong 1980: 69-70)

In response, the convicted businessmen persuaded the government to actually help them build new industries under the long-term development plans. When the plants were completed, they were to pay the imposed fine by yielding a majority share of the stocks to the government. The military junta, however, allowed businessmen to pay in cash instead of giving up ownership, thus leaving control of the firms in private hands (Kim 1976: 471).

In fact, nationalization of industrial facilities was not a feasible option to the junta, since the U.S. government was a critical of the junta's playing with the "communist idea." General Park was deeply concerned about the suspicion American officials had – he had been a communist organizer of high level in *Namnodang* (South

Korea Labor Party) before the Korean War. Furthermore, the junta desperately needed a tremendous amount of cash to create its new civilian political organization, the Democratic Republican Party.

Interestingly enough, the junta confiscated commercial bank shares from the big businessmen. The accused business leaders gave up their equity shares in the banks to the government, but received promises of credit-based industrial financing. The military government controlled what French jurist Jean Bodin called "the nerve of the state,"[4] which resulted in a credit-based financial structure for industrialization, as in France and Japan. The advantage of the credit-based system is that the state can influence the economy's investment pattern and guide sectoral mobility. In such a structure, firms rely on bank credits for raising finances beyond retained earnings and respond quickly to the state's policy, as expressed in the interest rate and preferential policy credits (Zysman 1983: 76-7).

The Decree and subsequent events might be called a "historical compromise" that shaped the growth-oriented developmental coalition up to present day in Korea. The Park regime traded off the confiscation of illicit wealth that big private enterprises had gathered during the 1950s for their cooperation in industrialization that the regime proposed for its political legitimacy and survival. Granting industrial ownership to entrepreneurs while keeping them on a tight leash via financial control, the junta set up its developmental coalition.

Here we need to pay attention to the Federation of Korean Industries (FKI)[5], a national organization of businessmen, and EPB, since they have been two institutional bases for the developmental coalition since the 1960s. The military junta released thirteen businessmen who were in jail for one and half months, requesting economic cooperation with its economic plan. In response, those entrepreneurs organized FKI which represented member industrialists' interests to the government via policy proposals and lobbying.

The FKI was more than an interest group. It was an institution through which the government designated the member businessmen to several industries strategic for rapid

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[4] This is requoted from Woo-Cumings (1999: 10).

economic growth. For example, in the summer of 1961, the junta offered as key industries cement, chemical fiber, electricity, fertilizer, steel, and oil refining, asking the FKI's member businessmen to select a few sectors in the form of single or joint venture. The cement industry was allocated to Kumsung textile; fertilizers to Samsung and Samho; electricity to Daehan Milling; steel to Daehan Cement, Kukdong Shipping, Daehan Industry, and Dongyang Cement in joint enterprise; and the chemical textile to Hwashin, Chosun Textile, and Hankuk Glass (FKI 1991:61). Furthermore, the FKI often drafted its own investment plans such as the Ulsan Industrial Park and proposed it to EPB that in turn accepted and implemented the proposal (FKI 1991: 64).

Before the coup, it was at the level of individual firms that businessmen pursued their own profits and competed with each other. For example, competition in the auction of Japanese colonial enterprises, bidding for aid materials and funds, and use of personal ties for import quotas and licenses individualized their identity. After FKI was set up, the member businessmen gained a collective identity by the vehicle of the national umbrella organization (FKI 1991: 65-6). They organized themselves as a capitalist class beyond individual firms. They became eager to give input on sectoral and macroeconomic policy proposals to the government and implemented industrial tasks that EPB allocated to them. They became private agents of political legitimatization, monopolized each sector allotted by the state, and obtained various incentives such as cheap foreign loans and foreign exchange, tax relief, and preferential credits. Entrepreneurs in Korea formed themselves into a class not in conflict with organized workers as in advanced countries, but in cooperation with the state. They were, however, political capitalists in that "they played on political connections to gain economic favors in exchange for political contributions" (Kim 1976: 469). They were the junior partner of the developmental coalition depending on state-generated rents.

Another pillar of the developmental coalition was the EPB. Bureaucrats began discussing economic planning in the late 1950s, although it was not actualized due to policy disagreements in officialdom and political instability. The military junta stepped in and took command. After researching Japanese and Indian experience, General Song

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[5] FKI was called AFI (Association of Korean Industries) before 1968.

Yochan, a leader of military technocrats, and his staff set up the EPB, taking budgeting from the Ministry of Finance, statistics from the Ministry of Interior, and planning from the Ministry of Construction. The EPB head was given the title of Deputy Prime Minister. It took about two months for the junta to set up this supper-ministry after the coup (Lee 1993: 77-87). Such rapid institution building was possible because the junta had to convince the people of its political enthusiasm for economic development. The principal ideology that the EPB adopted for industrial growth was an "economy of scale" based on mass production and capital concentration for rapid growth, which resulted in a big business-oriented growth strategy.

The EPB was the *de facto* and *de jure* center of rapid industrialization like "a train to move forward through history as fast as possible" (Gramsci 1971: 98). It formulated, implemented, and supervised every economic plan, which transformed the underdeveloped agrarian society to a middle-income industrialized one in only two decades. They controlled the cross-sectoral flow of economic resources and pressured the central bank to adjust monetary supplies and interest rates to their economic goals. They also determined "which firms invest how much funds to which sectors" and "which firms are out of market," taking full responsibility in every corner of economic affairs. EPB was, in Ralf Dahrendorf's term (1968), "plan rational," rather than "market rational," in that rather than accepting some predefined place in a world divided on the basis of "comparative advantage," it sought to create "competitive advantages" by sophisticated planning.

EPB enjoyed indicative authority and autonomy vis-à-vis big business during the 1960-70s industrialization era, more than its Japanese counterpart MITI (Ministry of International Trade and Industry) did vis-à-vis *Zaibatsu*. The Korean state was senior partner of the developmental coalition. Two political economists compared the Japan with the Korea as follows:

> In Japan, ascension to the top of both executive and legislative branches requires success in electoral politics, especially in the parliamentary system, and this in turn depends heavily upon the financing and support of business. In Korea, Park's original power base was the military and other executive agencies.... When elections have been held, they have been

> financed by levies on the business community. This has taken the form of an unavoidable political tax levied by a powerful incumbent, rather than a discretionary contribution that imposes obligations on the recipient. (Jones and Sakong 1980: 67-8)

What was the role of the governing party in developmental coalition? The military government set up the Democratic Republican Party (DRP) in May of 1963, with the help of the Korean Central Intelligence Agency (KCIA), to mobilize civilian support for the Park regime and to offset criticism from opposition parties for its lack of democratic legitimacy. The DRP argued that their political aim was to uphold the spirit of military "revolution," purify political culture, and push a generational shift in political scene (Central Council for Election Management 1968: 262). The DRP organization was "a highly centralized structure, with a disciplined party membership, and a single command from the headquarters to the provincial, city, and district branches. The party secretariat had 1,300 permanent salaried staff members, and its operation cost was estimated at 700,000 dollars a month in 1966" (Kim 1975: 236). DRP was a modern political party in terms of organization, totally different from previous parties which were actually loose and personalized cliques or elite groups in Seoul. DRP was an "externally created party." Such parties tend to be more centralized than those that are internally created, "more ideologically coherent and disciplined, less subject to influence from the legislative contingents of the parties, and generally less willing to ascribe major importance to or be deferential toward parliament" (LaPalombara and Weiner 1966: 10).

DRP's original plan was to subordinate government activities to the party, especially its central standing committee, and to make DRP the center of national power in the hope of spreading their spirit of military "revolution" to the government and society (Kim 1975: 235). But economic bureaucrats regarded "bending" to party influence as diverting government attention from its priority tasks, assuming that narrowly partisan interests could not represent the national interest. The military government supported developmental technocrats at the expense of its own political arm in the legislature.

> President Park frequently faced serious party challenges to the basic organization and direction of the economic program, usually centered on the EPB head, Chang Key-young. The president twice intervened personally, in 1965 and 1966, to choke off an attempt from the DRP to obtain votes of nonconfidence in Chang…. This conflict was a struggle for economic power. The president was prepared to defend the highly centralized and aggressive direction of economic policy that had developed under Chang and to keep policy initiatives in the hands of those primarily loyal to himself, rather than to the more diverse interests of the party. President Park was determined to maintain the cabinet largely intact as a whole against repeated appeals from the DRP for a major shake-up. (Cole and Lyman 1971: 96)

Thus DRP and the legislature, the National Assembly, were relegated to a "rubber stamp" for the executive branch of the government, passing most of the bills bureaucrats proposed to the floor. The government frequently pressured the legislature to pass its bills on a schedule determined by the president. "In frustration, the opposition reacted by liberally using its prerogative to question cabinet ministers on political issues. This made it a valuable democratic forum for certain public issues but had little more than nuisance value in affecting the executive's developmental policies"(Cole and Lyman 1971: 244). Some statistics show the government's dominance in public law and policy making over the legislature: 84 percent of the passed bills in 1970s were initiated by the government, rather than members of the legislature (Jones and Sakong 1980: 28). Furthermore, after the revision of the constitution in late 1962 that institutionalized strong presidentialism, President Park used his own decree power to push growth-first plans, bypassing public discussion in the legislature: of 84 major economic bills between 1961 and 1991, 79 were enacted by presidential decrees and the rest were passed in the name of administrative orders at the ministerial level.[6] The governing DRP and the opposition did not propose any significant policy bills in the turbulent industrial transformation era. They did not check and balance developmental technocrats by gathering various societal inputs form society.

Was there any political challenge to EOI developmental coalition driven by EPB technocrats and FKI industrialists? Unlike Taiwan, Korean authoritarian government did

[6] I calculated the figures based on Korean Development Institute (1995) and Lee (1993: 394-403).

not dare to suspend the political schedules of elections at the national level, which suggests that political leadership felt a serious burden from periodic electoral competition, which allowed opposition parties to rally urban citizens.

It was in the early 1970s that the coalition faced serious political challenges from opposition parties. Two elections in 1971 showed that even restricted democracy could not be an institutional framework to sustain an unbalanced growth-oriented industrial strategy. Although Park won the presidential election of April 1971 with 53.2% of the votes, 45.3% went for the young prominent opposition candidate Kim Dae Jung from the New Democratic Party (NDP). Kim waged an influential campaign against the Park regime. One month later, DRP earned 48.8% of the total votes while the NDP garnered 44.3% in the general election (Central Council for Election Management 1982: 582, 564), which threatened the political survival of authoritarian elites. During their campaign, especially in urban areas, Kim Dae Jung and the NDP focused on fair economy and democracy including greater control of inflation, public sale of corporate shares in large firms, greater opportunity for small business, balanced rural-urban development, a self-reliant national economy, and opposition to developmental dictatorship (Central Council for Election Management 1982: 571-6). Their campaign was a populist appeal to the mainly urban liberal sector, white collar workers, students, intellectuals, and workers, who formed a loose distributional coalition.

The Park government was confronted with two options. One was to continue the narrow developmental coalition with chaebols, excluding the popular sector. The other was to incorporate the subordinate groups into its developmental scheme. Those 1971 elections reflected the people's voice against ills created by an unbalanced economic growth where big business monopolized the economic benefits. Democratic opposition wanted to "expand public investment in the agricultural sector and create a domestic market by increasing the supply of wage goods and the income of the popular masses while maintaining an open development strategy" (Im 1987: 266).

The Park government stuck to the first option. With the Emergency Decree on National Security at the end of 1971, Park forced a more stringent "bureaucratic authoritarian regime" (O'Donnell 1973) with a change in the constitutional framework, the *Yushin* Constitution, by which he was allowed to select a third Assembly member at his disposal without elections. Setting up the *Yushin* regime by *autogolpe*, the Park government depended on a more dangerous degree of economic success to compensate for its lack of democratic legitimacy. "The more insecure the government became, the greater the pressure on industry to expand" (Pye 1988: 85). The government launched this industrial deepening in 1972.

In fact, in the late 1960s and early 1970s, the Korean economy mainly had two problems: saturation of light industrialization and debt-ridden firms. Growth via labor-intensive light manufacturing in the 1960s reached its limit and there was a policy proposal from bureaucrats arguing for the need to seek another developmental alternative. True, Korean industries depended on imported capital and intermediate goods purchased with external financing, which resulted in the pressure of debt services and thus debt-ridden firms' bankruptcy in late 1960s. To solve the saturation problem, the government chose to upgrade its industrial structure from light industry to "heavy chemical industrialization" (HCI) in 1972. It officially targeted six industries (steel, chemical, metal, machine-building, ship-building, and electronics) for import substitution of capital and intermediate goods (Lee 1993: 176-80).

Responses were critical of the HCI plan. The American government criticized the HCI strategy since it believed that the plan was "unsuited to the factor endowments and small domestic market in Korea" (Kuznet 1977: 152). In other words, "Korea was violating a rational international division of labor" (Cumings 1987: 76). FKI was deeply concerned that the plan would limit private firms' initiatives in the free market, and some EPB bureaucrats claimed that they could not mobilize massive capital and high technology to implement the plan (FKI 1991: 128; Lee 1993: 222). Since the HCI was a direct result of executive initiatives aimed at political legitimatization through industrial performance, President Park openly bypassed policy deliberation among officialdom, academia, and interest groups. Now, the practical problem boiled down to how to mobilize financial resources for the grandiose industrial voyage to an uncharted sea.

To clear away the financial constraint, the government pronounced the August 3 Decree in 1972 which was inconceivable in a free-enterprise or laissez-faire economy. The decree was to "confiscate" financial resources from financiers and private savers. Its main features were:

> All the loan agreements between business and lenders in the unregulated financial market were nullified and replaced by new ones. The borrowers would have to repay loans over a five-year period after a three-year grace period, carrying a 1.35 percent monthly interest rate, or the lenders had the option to switch their loans into shares of the borrowing firms. Some of the short-term high-interest-rate bank loans by business firms were replaced by long-term loans at an 8 percent annual interest rate, payable over a five-year period, after a three-year grace period. An overall reduction in the interest rates of banking institutions lowered the time deposit rate from 17.4 percent to 12.6 percent and general loans up to one year form 19 percent to 15.5 percent. (Cole and Park 1983: 162-3)

What the Park government feared was that increasing business bankruptcies would undermine the nations' credit standing in the world market and hamper the inflow of foreign capital, which ran counter to the high growth objective of the government. As a result, the government decided to bail out those troubled firms. The volume of informal loans reported by firms "amounted to 345.6 billion won, approximately 80 percent of the money supply at that time" (Cole and Park 1983: 163). When facing economic troubles, the government coercively mobilized financial resources from the market, foreign or domestic, and distributed them to selected firms that would follow official economic strategies. This is a patterned dynamic of "financial crises – industrial restructuring" which was repeated in the early 1960s, early 1970s, early 1980s, and 1998-9.

As Gerschenkron commented on German-style late development, "the supply of capital ofr the needs of industrialization required the compulsory machinery of the government, which… succeeded in directing incomes form consumption to investment" (Gerschenkron 1962: 20). The HCI-*Yushin* regime was an upgraded version of developmentalism. The National Investment Fund (NIF) was established in 1973 to maneuver the financially leveraged big firms into new heavy and chemical sectors. The NIF extended 65.5 percent of its total funds to HCI sectors during 1973-78. Thus the ten biggest firms' average assets invested in the HCI sectors were 70.6 percent of their total assets in 1972 and 84.7 percent in 1979 (FKI 1991: 296). Policy loans issued by the Bank of Korea (BOK) were 55.2 percent in 1975, 78.6 in 1978, and 59.3 in 1980 out of the total BOK loans (Woo 1991: 162). As a result, the developmental coalition gave birth to the "too-big-to-fail" problem in Korean society which Theodore Lowi (1969: 279-280) called "permanent receivership," where:

> A government maintains a steadfast position that any institution large enough to be a significant factor in the society may have its stability underwritten. It is a system of policies that sets a general floor under risk, either by attempting to eliminate risk or to reduce or share the costs of failure…. Permanent receivership would simply involve public or joint public-private maintenance of the assets in their prebankrupt form and never disposing of them at all, regardless of inequities, inefficiencies, or costs of maintenance. This is quite conceivable as long as a government or a large private enterprises assure all the creditors that they would be better off allowing the original enterprises to continue operations than if they liquidated and took their ten cents on the dollar.

In summary, the Park government's developmental coalition with big bourgeoisie was motivated from its lack of democratic legitimacy. The government felt it urgent to impress citizens with its economic performance until the next election came near. The state invited *chaebols* to the coalition and poured financial resources into them, alienating the popular sector and other subordinate groups. The FKI and the EPB were the main institutional arms used to sustain the unbalanced growth strategy and the political elites protected industrialists and technocrats from distributional demands.

Taiwan: Broad Coalition without Big Business and Balanced Stability-Oriented Strategy

The Taiwan case shows how political interests during the state-formation process molded the organizations of private interests in society. As Otto Hintze (1929: 427) emphasized, "the rise and development of capitalism remains unintelligible without an insight into how it was conditioned by the course of nation-building and by the spirit of politics."

According to Barrington Moore, the KMT represented a reactionary and protofascist element in the transition to a modern China. The KMT's main social basis was, despite its nationalist and revolutionary discourse, "antagonistic cooperation between rural landlords and urban commercial, financial and industrial interests. The KMT, through its control of the means of violence, served as the link that held the coalition together, which resembled Franco's Spain and Hitler's NSDAP" (Moore 1966: 196-7).

Then, what were the political conditions under which the KMT government chose to broaden its developmental coalition after the Nationalist' relocation to the small island? First, the Nationalists did not find a big bourgeoisie on the island who were reliable for the industrialization project. When the émigré government crossed the Taiwan Strait to *Formosa* (i.e., old name of Taiwan) in 1949, the majority of the mainland private financiers and industrials fled to the U.S. and Hong Kong. Counterfactually speaking, if they had followed the KMT, the Nationalists might have pursued the Malaysian path, where ruling elites deliberately nurtured entrepreneurship within their ethnic group, *bumiputera* (sons of the soils) in the name of the New Economic Policy (NEP), discriminating against the local wealthy Chinese business community.

The second condition was the existence of a sub-ethnic cleavage that divided the mainlander and the islander. The Nationalists found themselves in an alien society: they constituted only a 15 percent minority while 85 percent of the inhabitants were native Taiwanese (Cheng 1993: 59). The sub-ethnic difference was an important barrier, with the mainlander political elite being differentiated from the Taiwanese business elites. For example, the Economic Cooperation Administration reported after an extensive field survey as follows:

> They [Taiwanese manufacturers] emphatically said that they employed no mainlanders in their plants and had no intention of doing so, and added that no Taiwanese hold responsible positions in government factories. The Chinese government has not cultivated the loyalty and cooperation of the Taiwanese people. (Simon 1988: 147)

The KMT leadership viewed the formation of private indigenous economic power as a challenge to their hegemony on the island. Thus, the Nationalists could not count on indigenous economic elites as private agents of economic development as in Korea. Instead, they chose to nationalize major Japanese colonial firms and islander-owned enterprises, transforming them into SOEs that in turn created a lot of jobs for government officials from mainland China. As for landlords, the KMT crushed the traditional rural elites by executing land reforms which later became the material base of rural support for the émigré government. It was at the socio-economic level that the Nationalists forged a loose but broad coalition with social groups to consolidate their power in the popular sector.

In addition, the KMT government's agenda emphasized economic growth with macroeconomic stability, equity, and redistribution. The coalition adopted a balanced strategy to narrow sectoral, regional, rural-urban, and interclass gaps. The inflation rate is a good example of the balanced growth of the island economy. Taiwan was successful in keeping its inflation in the single digits, averaging 6.5 percent between 1955 and 1990 (Council 1995). According to Charles S. Maier, a high inflation rate has a socioeconomic base, since it can be conceived of as a failure of production to respond to expectation among economic actors. The rate of Taiwan's inflation fits the "creeping inflation" type. The prerequisite for this type is economic growth that avoids a harsh distributional conflict between classes, keeping the "balance of social forces" and "general consensus of all classes on high employment and welfare" (Maier 1978: 43, 59).

But indigenous islanders could not have political representation in proportion to their population, especially at the national level. A record of the ethnic breakdown of the KMT's Central Standing Committee (CSC), the power center of the party, shows that indigenous membership constituted, on average, 3.6 percent in 1950s, 9.3 percent in 1960s, and 20.6 percent in 1970s (Pang 1992: 66). Furthermore, the Nationalists imposed an Emergency Decree by which martial law came into effect from 1949 until July 1987, although many measures like military law, curfews, and military street patrols were not utilized.

The distinctive feature of the politics of the economic development in Taiwan is that the Nationalist party assumed the supreme authority to sustain and supervise the broad coalition and its economic projects. Given the fusion of the party with the state, the KMT provided the only formal links and coordinating mechanisms among the disparate arms of the state. All the major government appointments and decisions and all the proposed legislation had to be approved by the CSC of the party. No branch of the state apparatus, not even the judiciary, was immune from the influence of party bureaucrats.

For almost four decades, no opposition party was legally allowed to form and compete with the KMT.

The KMT dominated the Legislative Yuan. 539 out of the 760 who were elected in 1948 had followed Chiang Kai-shek across the Taiwan Strait to the island, constituting an overwhelming majority of the Yuan. Those "old" members held their posts without re-election for more than three decades. To fill the national elective offices when old members died, as well as to broaden the foundation of the government, elections have been held since 1969. As a result, in 1985, the new membership totaled 348, although more than 80 percent were the KMT members (Pang 1992: 73).

In a way, the KMT was an institutional twin of the Communist Party in mainland China (Linebarger 1937: 161-4). The party permeated almost all aspects of political life, with membership reaching almost 20 percent of the entire adult male population (Chu 1994: 116). Gold (1986: 60) describes the KMT's dominant position on the island as follows:

> The KMT is still Leninist in structure and in its democratic-centralist principles of organization. Its rank and file is members of party cells that exist in schools, the military, residential street offices, enterprises, social organizations, and overseas Chinese communities. Their main function is to ensure that party policies are implemented and to resist challenges to KMT domination. Four hundred service centers around the island provide a variety of social services as well as a means of keeping informed of local affairs. 'Security offices' in private enterprises, schools, and civic bodies perform a control function. At the local level, party cadres are also charged with selecting candidates for elections and using whatever means are necessary to see them through to victory. This function gained in importance with the implementation of local self-government. It often meant coopting local elites and manipulating extant factional conflicts.

Comparatively, the KMT succeeded in institutionalizing its authoritarian rule through the vehicle of the pseudo-mass party, while the ruling DRP in Korea failed to institutionalize their rule over society because they were threatened by opposition parties and democratic upsurges. The KMT generated and approved major governmental policy decisions. Politically sensitive economic decisions like financial, monetary, and industrial policies required cooperation with party leaders. As a result, economic officials were not entrusted with the power to manipulate economic policies. "Senior economic policy makers did not enjoy the same political standing as their rivals in the military and security agencies and senior party officials in charge of organizational and ideological affairs" (Chu 1994: 117). In terms of membership of the CSC in 1952 through 1984, political elites dominated the CSC over military, economic, and cultural leaders: members with a political background were 51.67 percent in 1950s, 50.34 in 1960s, and 40.2 in 1970s and early 1980s, whereas members with an economic background were 3.74, 8.67, and 26.76 in respective periods (Pang 1992: 69). A wide range of public policies were off-limits to the economic bureaucrats at the Ministry of Economic Affairs (MEA) and the Council of Economic Development and Planning (CEDP). Furthermore, economic bureaucrats' actions were subject to surveillance by security agencies and party officials. "Leniency toward private vested interests could be mistaken for favoritism" (Chu 1994: 118).

Then, what policy orientation did the party officials impose and disseminate to the developmental technocrats? An official partisan doctrine is the Principle of *Minsheng*, people's livelihood, which was meant to push late industrialization in China, without the pathology of the class struggle. Programs supporting this principle are the promotion of state capital, regulation of private capital, direct taxation, and socialized distribution of wealth (Sun 1927: 386-9). Although the principle was ill-defined and subject to various practical interpretations by the Nationalists, it surely was the main concern for party leaders like Chiang Kai-shek when he argued:

> Almost every one of our comrades knows that our failure in the anti-communist struggle is due to our neglect of the *Ming-sheng* Principle in the mainland. Every comrade also knows that henceforth in our anti-Communist struggle we must rely on the Principle. We should realize the *Min-sheng* Principle through practical action, not theoretical discussion. (Pang 1992: 84)

Thus when economic technocrats proposed a highly preferential credit policy and privatization of state capital for rapid economic expansion, their proposal was counterbalanced by the KMT's strong obsession with keeping monetary stability and financial orthodoxy, and with sustaining broad support among SMEs, farmers, and state employees.

Then how did the KMT government achieve speedy economic growth when it invited diverse private interests into the developmental coalition? How did they orchestrate various economic agents' passion and interests into one national effort as they desired? The KMT maintained the broad socioeconomic coalition through "field manipulation," rather than selective intervention or command, so that the government looked relatively neutral to sectoral or regional interests and took a more balanced view of development (Ho 1978: 251). According to Dahl and Lindblom, a manipulated field control is "deliberate action on another person's field (by means other than command) in order to secure a definite response, by manipulating signals about rewards and deprivations" (1953: 104). Compliance or non-compliance is up to the controllee's decision and is on its own reward. Field manipulation either expands the perceived opportunity set, or alters expected payoffs from particular courses of action. Command, on the other hand, reduces the feasible opportunity set, assuming there is sufficient compulsion to make it operable (Dahl and Lindblom 1953: 104-108).

Taiwan basically used a field manipulation mode of market intervention while Korea heavily relied on a command approach, often with good effect (Jones and Sakong 1980: 84). A KMT official commented on field manipulation by saying:

> The KMT was actually an "invincible armada" in this island. Some people say we always imposed our will to society. Yes, it is true. But that's a half story. We were constantly concerned about our fairness and neutrality toward various socio-economic groups in market. In my opinion, we might have to adopt the [field manipulation] strategy not to give impression that the KMT favored a few vested social and economic interests, keeping our broad support bases sustainable. We knew we were a minority ethnic group. And our efforts worked.(interview, summer of 2003, Taipei, Taiwan)

According to Ian Little, although Taiwan's economic plan was not very different from those found in developing countries, the core of the Taiwanese plan consisted of the macroeconomic projections that had no planning force – unsupported by controls. Taiwan's loose plan and non-commanding style lacked the mechanisms associated with indicative planning. “There were no standing consultative committees with private industry; any consultations were ad hoc. There were virtually no teeth either. Thus, the textile industry was apparently rightly warned that it was overinvesting in 1973, but it went ahead anyway” (Little 1979: 487-8).

To encourage industrial growth, Taiwan depended on fiscal incentives, especially tax reductions, while Korea mainly relied on discretionary control of policy credit allocation (Kim and Yu 1998). As Zysman suggests, taxation, a typical example of a fiscal measure, is not as flexible as credit allocation. “Taxes can be used to target categories of action but they are difficult to manipulate toward specific industrial ends. Moreover, taxes operate to increase profits from gross earnings; they tend to follow rather than to lead new industrial activities” (1983: 77). According to Cheng (1990: 158), fiscal incentives were the main financial instrument for SMEs, the backbone of the national wealth:

> “Fiscal incentives in Taiwan forced a choice between an attractive tax holiday for new undertakings and a depreciation allowance for the established firms, a choice leading to the proliferation of new but small-medium firms. The reinvestiment restriction of the Company Act also dissuaded firms from branching out… The Act was very restrictive in the scope of business operation as well as the interfirm equity flow, which had the effect of dissuading industrial concentration.

Government-business relations in Taiwan were relatively “distant and cool.” The relations are characterized by “commensualism” (i.e., they cooperated but acted as two separate parts), rather than the “symbiosis” (i.e., they not only cooperated but also acted as an integral unit) as found in Japanese or Korean political and economic elites (Pang 1992: 113). The story of the steel industry shows how the KMT treated private business associations in its developmental project.

In 1962 the Taiwan steel sector organized their national peak association, the Taiwan Iron and Steel Industries Association (TISIA). The Association set up a cooperative export system where it fixed export prices, set up a common fund for export promotion schemes, and regulated under- and over-production. “The system also helped reduce downward pressures on domestic steel prices. But as the number of member firms increased, they became the focus of repeated controversies within the government, and finally collapsed in 1971" (Nobel 1998: 74).

It collapsed because the industry association attempted to form cartels and other forms of collective action and thus their efforts were blocked by the government. Gregory Nobel (1998: 73) explains as follows:

> While the Industrial Development Bureau (IDB) of the Ministry of Economic Affairs was sympathetic to industry requests for collective adjustment of capacity, the higher and more political levels of the regime remained resolutely opposed. The president and his top advisers, the Ministry of Finance, and most ministers of economic affairs were profoundly skeptical of the private sector and unwilling to countenance private cartels.

Outside observers complained sardonically about the Nationalists' attitude toward the association, comparing it to their idealized Japanese and Korean counterparts (Noble 1998: 81).

> In Taiwan industry associations rarely have administrative leadership functions. This is not a problem of the iron and steel industry association alone but of all the industry associations. Currently, the iron and steel industry associations in Japan and Korea have the ability to regulate the production and sales of their members. If we look back at the iron and steel industry association in our country, to the present day it has not even been able to publish a single journal. How could we expect it to have the strength to regulate production and sales?

The story does not necessarily mean that the KMT government was passive about industrial deepening. Rather, the government launched their sixth four-year plan (1972-76) that called for developing heavy and chemical industries to replace imports of intermediate raw materials and capital goods, and to increase exports. The government commissioned Arthur D. Little, Incorporated (ADL) to suggest an economic strategy; ADL advised upgrading by investing in petrochemicals, electrical machinery and equipment, electronics, precision machine tools, and computers (Gold 1986: 94).

Given that heavy industrialization is a capital-intensive project, how did the KMT implement its industrial deepening without nurturing private big businesses that could threaten its balanced coalition? The Nationalists' solution was to allow the state sector to lead the EOI deepening. In a sense, the HCI project was launched against the backdrop of an uneasy relationship between the KMT government and local industrialists. The reentry of state capital was justified in the steel and shipbuilding industries since high capital intensity and a long gestation of investment might deter private initiatives. While the Park regime in Korea urged private big businesses to join the grand projects and thus coordinate what each firm specialized to produce, the KMT government strategically put its SOEs in major backward industrial linkage, and dispersed private investment in various productions. A story of the petrochemical industry shows how the KMT orchestrated a balanced growth strategy inviting SOEs, big business, and SMEs in that sector.

SOEs, like China Petroleum Corporation and Taiwan Fertilizer Corporation, monopolized oil refining and upstream basic feedstocks (Naphtha, Ethane, and Benzene). Taiwanese *jituanqiye*, big business groups, purchased upstream materials and produced midstream intermediate raw materials (vinyl chloride and ethylene glycol, etc.) which are obtained by SMEs who manufactured downstream final products (plastic and rubber products). Output of SOEs and business groups was usually for domestic sales while SMEs produced petrochemicals for domestic consumption and, in larger amount, export. As petrochemicals were exported by SMEs – the backbone of national wealth – the SOEs and big private enterprises could not form a cartel to put the squeeze on SMEs by price collusion because their profits depended on SMEs' price competitiveness in foreign markets (Tuan 1990). This industrial arrangement is a stark contrast to the Korean experience where a few *chaebols* like SK, LG, and Samsung dominated the petrochemical industry, each firm maintaining vertical integration from oil refining to finial products for export (Chung 1999: 112-3; Shin 1999: 324-5).

The KMT government got SOEs, big firms, and SMEs involved and designed a "checks and balance" system in the petrochemical industry while maintaining its strategic position in overall backward linkage. Ying-yi Tu (2001: 236) describes the government's policy toward the petrochemical industry as follows:

> The KMT government, with the objective of discouraging monopolitistic behavior of the large business groups, did not allow the petrochemical industry to develop into an integrated operation. Instead, the operations of upsteam and midstream manufacturers were separated from each other. Midstream operations were in turn segregated into a series of manufacturing processes, with a corresponding increase in the number of manufacturers. Unfortunately this resulted in products at various states of completion changing hands more frequently, and overall production costs increased.

Sometimes there were price disputes among SOEs, business groups, and SMEs. For example, in 1979, midstream suppliers sold their products in foreign markets because world prices were higher than domestic ones. As a result, local downstream SMEs suffered from insufficient supplies of intermediate materials. In response, downstream producers increased their imports of intermediate raw materials in 1980 when the world prices were relatively low. It was a game of "prisoners' dilemma" where each sector pursued each short-term interest at the cost of overall and long-term prosperity. The KMT stepped in, orchestrating a compromise by influencing the upstream manufacturers, mostly SOEs, to lower the prices they charged to midstream producers, who in turn lowered the prices they charged to the downstream producers (Tu 2001: 243).

It should be noted that the capital-intensive industrial upgrading plan in the 1970s was motivated not only by a saturation problem that successful light industry in the 1960s came to face. Several political factors contributed to the industrial transformation just as in the Korean case: geopolitical change and political succession problems.

The Nationalists experienced many diplomatic disasters in the early 1970s: the successful PRC's atomic bomb test in 1964, the secret visit to China by Henry Kissinger in July 1971, the UN's ostracism of Taiwan in the fall of 1971, and President Nixon's Shanghai Communiqué with Chou En-lai in February 1971. This series of events seriously challenged the KMT's boasts about retaking the mainland by force. It was under the national security crisis that Chiang Ching-Kuo, son of Chiang Kai-shek, became premier in 1972.[7] He actually dominated the politics of the island on behalf of

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[7] Chiang Ching-kuo dominated the politics in early 1970s due to the untimely death of his chief rival, Ch'en Ch'eng in 1965, and the progressive physical weakness of his father, Chiang Kai-shek. He was a

his father who then was physically weak. He had been a security czar controlling the military and intelligence agency until the early 1970s, when he gathered the instruments of economic policy making around the premier's office, ousting his old rivals, Hsu Po-yuan and Li Kuo-ting. He came to power in 1972 and he launched the next year the Ten Major Development Projects (TMDP) including transportation system (freeway, railroad, airport, and harbor) and heavy chemical industries (integrated steel mill, petrochemical complex, shipyard, and power plants) (Gold 1986: 93, 98). As he actually succeeded to his father's political power during the crisis of confidence in the ability of the Nationalists to control the island's fate, he enthusiastically implemented the TMDP. A professor commented on the TMDP as follows:

> Chiang Ching-kuo was the security czar in the 1960s during which he took charge of national defense and military intelligence under the auspices of his father. But the diplomatic crisis of the early 1970s proved that national security and reunification that he had been involved in were simply a failure. Furthermore the first oil shock was ready to upset Taiwan, an export-dependent small open economy. As he became the premier in 1972, he needed to do something different that could legitimize and consolidate his power. In a way, the Ten Major Development Projects played the role. He decided to push the plan to boost the self-confidence of the people and survive the turmoil of the days. The project was, in a way, a result of diplomatic and economic crisis and political succession problem (interview, summer of 2003, Taipei, Taiwan).

The aforementioned regional shakeup of geopolitics also affected Korea in the early 1970s, when the Park government launched the HCI plan in response to the Nixon administration's recognition of the People's China and its withdrawal of a division of U.S. troops out of Korea. The Park government pressed for the HCI project, arguing that "the [HCI] project would keep the Korean peninsula safe from communist threats because the American government would not let any free country with considerable industrial capacity fall under the control of communists" (Kim 1990: 359).

Whereas in 1972 the Park government moved to a more exclusive *Yushin* regime by *autogolpe* to push the HCI, the KMT did not move in such way. Rather it started

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security czar by his influence in the military and security apparatuses. He became minister of national liberalization and Taiwanization to break through the confidence crisis. The measures were aimed at "moderation by engagement," making Taiwanese disappointments and complaints about the KMT fizzle out. In 1969 it held the first elections in two decades to fill the increasing vacancies in the National Assembly, Legislative Yuan, and Control Yuan. The diplomatic setbacks in the early 1970s pressured the mainlanders into opening more opportunities in local government for Taiwanese people. In 1972, indigenous local politicians constituted 58 percent of the provincial government councils, 97 percent of the provincial assemblies, and 100 percent of the county executives. In addition, the KMT sought to recruit indigenous islanders as its nominees: they constituted 88 percent of total party nominees in the Legislative Yuan, 91 percent in the National Assembly, and 60 percent in the Judicial Yuan. The Taiwanization was, however, limited to the legislative branch of the national government, and executive and legislative branches of the local government. Key portfolios in the KMT government were still dominated by the mainlanders: Taiwanese were 14 percent in the KMT Central Standing Committee, 19 percent in the party administrative leaders, and 32 percent in the Cabinet (Jacob 1973: 109).

III. Conclusion

The chapter has discussed the political conditions under which two Asian NICs invited different socioeconomic groups into their developmental coalitions. It also compared how each government managed and sustained its own coalition during great transformations from poor rural societies to upper-middle-income countries.

General-turned-president Park's authoritarian regime suffered from a lack of political legitimacy since it originated from a military coup in 1961, crushing the April Uprising of 1960 and the democratic Chang Myon government. The developmental regime based its legitimacy on economic developments that the preceding governments had failed to achieve. Furthermore, the Park government was subject to a short time horizon: it had to prove its economic legitimization before the next election. Thus the government employed the "economy of scale" strategy and chose a few big businessmen

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defense in 1965 and vice-premier in 1969.

as industrializing agents, pouring tremendous amounts of financial resources in the form of policy loans. Since the political leadership excluded the government party from economic policy making, the party could not counterbalance the technocrat-led growth-first drive tolerating macroeconomic and financial instability.

In the case of Taiwan, the KMT learned the lesson of economic stability from their historical trauma, i.e., their defeat in the mainland of China and their retreat to the small island. Desperate and humiliated when crossing the Taiwan Strait, the KMT leadership implemented a stringent stabilization program in the late 1940s and early 1950s, which has been the policy core that guided the postwar "balanced-growth-with-stability" path until recently.

The KMT's anti-private capitalist ideology and *Minsheng* principle included various sectors like farmers, SMEs, SOE employers in its loose yet broad developmental coalition. Its dictatorial welfarism was possible given the sub-ethnic cleavages along which mainlanders monopolized public officialdom while indigenous Taiwanese were dispersed in the private sphere and were not able to concentrate economic power in a few hands.

The next chapter will compare Korea and Taiwan on a sector-by-sector basis (i.e., big business, SMEs, finance, agriculture, and labor) to show in detail how each sector was called into the developmental coalition in each country and what roles they played in it.

Chapter 3: Social Bases of Developmental Paths

This chapter utilizes detailed data and statistics about the social bases of developmental paths in Taiwan and Korea to demonstrate how developmental politics mentioned in the previous chapter were associated with divergent sectoral arrangements. On average, Taiwan was more successful than Korea in accommodating and balancing various private interests under the roof of a softer authoritarianism.

The first section discusses industrial concentration in each economy, focusing on *chaebols* in Korea, and SOEs and *jituanqiye* (business group) in Taiwan. The second section deals with the economic status of SMEs in each country including large-small firm relations, government's SME policies, and access to financial resources. In the third section, I show that although the two countries experienced relatively identical degrees of financial development, they were different in terms of financial mobilization, loan distribution, efficiency of the banking industry, financial ownership, and loan extending behaviors. The fourth and fifth sections look into the popular sector. The former discusses agriculture and the rural population. Based on the rural/urban bias in economic growth, farmers' interest representation, and agricultural institutions, I show that Taiwanese agriculture and farmers were more accommodated in rural-to-urban transformations than their Korean counterparts. The fifth section considers labor politics. Both countries started with a labor-intensive EOI path under labor-repressive regimes, although they differed in providing material benefits to rank-and-filers in exchange for the political demobilization of organized labor.

I. Big Business and Industrial Concentration

The Park government's developmental strategy favored *chaebols* as its private agents for industrialization. To survive competitive elections, Park needed to improve the country's economic performance prior to the next election. Thus the state nurtured the big industrial bourgeoisie by assigning them state-sponsored HCI projects and providing policy loans, tax exemptions, and favorable interest rates, even at the cost of monetary and financial instability.

In contrast, the KMT, influenced by the inflationary experiences of mainland China, deliberately restricted private capitalists and maintained a broad but loose developmental coalition on the island. Thus the *chaebols* developed at a phenomenal rate during the HCI period while the *jituanqiye* (business group) remained roughly the same size, as shown in Tables 3-1 and 3-2.

Table 3-3 shows more detailed information about the ten largest companies in Korea and Taiwan during mid-1980s. *Chaebols* are much bigger than Taiwanese business groups in terms of sales and employees. The biggest Korean conglomerate, Samsung, had a sales total of $21 billion for 1987, which is nearly 40% larger than those of all Taiwan's top ten companies combined. Samsung's 160,596 employees exceeded the total employment of the ten biggest firms in Taiwan by more than 50 percent. As for ownership, Korea's top ten firms are privately owned except for Pohang Iron & Steel while Taiwan's industrial pyramid is divided relatively evenly between four SOEs and six private companies. But combined sales and employees of the six private firms are 52 and 83 percent, respectively, of the four SOEs. Interestingly enough, neither country has transnational companies (TNC) in the top ten list. This is in contrast to Mexico and Brazil, two Latin American industrial rivals, where foreign firms play a substantial role in the economic sphere. In 1987, four and three foreign firms are listed in the top ten biggest companies in Mexico and Brazil, respectively (Gereffi 1990: 92).

The importance of public sector enterprises in Taiwan can be seen clearly when Taiwan's experience is compared with that of other countries. Table 3-4 shows that SOEs played a larger role in Taiwan than they did in most other developing and developed countries. Taiwan is similar to India and Indonesia, where the public sector traditionally leads industrial development. The percentage share for Korea is significantly lower than it is for Taiwan.

The share of the public sector in economic development in Taiwan as Table 3-3 and 3-4 demonstrate reflects the Nationalists' effort to counterbalance indigenous Taiwanese private capital. In addition, many leading economic officials in the government came from an industrial and engineering background and several had worked for the China Petroleum Corporation, an SOE, on the mainland. The KMT could not let them retire or go unemployed since they were a bureaucratic arm that would guide the émigré government along a developmental path.

Varying levels of industrial concentration are clearly indicated by Table 3-5 showing the GDP shares of the ten largest companies in four developing rivals. A striking contrast is that Korean *chaebols* account for 63 percent of GDP in 1987, compared to concentration ratios of 14.7 percent for Mexico, 10.5 for Brazil, and 14.3 for Taiwan. The Korean economy is 4.5 times more concentrated than the Taiwanese economy.

If we look at *Fortune*'s annual list of the world's 500 largest industrial firms, it is clear again that Korea stands out in the group of developing countries in 1988. Table 3-6 shows that Korea has eleven firms on the list, far more than any of the other developing rivals. Taiwan has only four firms on the list.

Then, how did the 'economy of scale' affect the profitability of the firms in the two Asian rivals? Table 3-7 shows that 'bigness' negatively affected profits in the manufacturing sector. The average profitability per asset was 7.22 percent for Korean and 13.76 for Taiwan; the average ratio of profit to sales was 2.64 percent for Korea and 4.38 for Taiwan. In general, manufacturing firms in Taiwan are roughly two times more profitable than Korean rivals.

The differential profitability originates from the fact that firms in Taiwan typically use their own funds without supersizing their business, while Korean firms do the opposite. When facing decreasing profitability, companies in Korea usually increase fixed investment with external financing for more market shares in trying to compensate for low profitability. Korean firms are bigger in average sale sizes than Taiwanese firms, although sales do not offset profit losses from debt services. This phenomena suggests that big Korean firms are likely to be tempted by the "moral hazard" or the "too-big-to-fail" problem: the more debt-laden a big firm gets, the more likely it is to be protected since the state and creditor banks step in to reschedule payments and funnel additional funds in order to reduce the dire effects failure would have on the whole economy.

Different sizes, ownership, and profitability are not the only criteria that differentiate the two countries. Big businesses in both countries differ in terms of their internal management relations. The authority structure that underlies the chaebols is a principle of *corporate patriarchy*, where "a huge industrial empire is the property of an authoritarian individual and his designees who manage them not by consensus but by centralized command" (Hamilton 1987: 102).

For example, Kun-Hee Lee, the chairman of Samsung Group, and his family own only 2.15 percent of the Group's total assets. Yet the boss controls the whole Group through a complicated web of cross-investments and cross-ownerships between the fifty-six member firms. The Group reorganized *kijosil* (office of planning and coordination) to support the boss' personal control of the whole group. Thus, it serves as the control tower that manages personnel, funding, information, and investment planning. It has 180 staffers in its eleven task teams, sometimes called "presidential secretary in the economic circles" due to its powerful influence (Bae et al. 2001: 97; Kang 1996: 153).

In contrast, big firms in Taiwan are less centralized than their Korean counterparts. *Jituanquye*, loosely knit private agglomerations, are based on the principle of a "patrilineal network" where:

> Firms tend to be organizationally separate from other firms, with no unified management structure. Instead of a formal system of command, one finds a highly flexible management arrangement that relies on networks generated by personal relationship based on reciprocal trust, loyalty, and predictability. The Taiwanese business groups do not express the will of a single patriarch but rather the interests of an extended family. (Hamilton and Kao 1987: 102)

II. SMEs and Economic Dispersion

As Korea and Taiwan chose different industrial strategies, the two successful small-open countries diverged in terms of their SMEs' status in the national economy. Table 3-8 shows that Taiwanese SMEs accounted for 65.2 percent, on average, of total exports in the 1980s while Korean ones exported only 29.4 percent of the total in the same period. SMEs' contributions to export-dependent growth are more than two times larger in Taiwan than in Korea.

Korean SMEs: Subordination to Chaebols

The developmental state in Korea drove SMEs into exporting textiles, apparel, machine parts, and electronics. During the 1970s, the Park government introduced 370

SMEs in three export industrial parks and 100 SMEs in two export free zones (EPB 1981: 312), a strategy also found in the Taiwanese case. What differentiates the two countries' SME policies is large-small firm vertical linkage in Korea and SMEs' networking in Taiwan.

While investing national financial sources into capital-intensive industries during the HCI period, the Park government made serious efforts to link chaebols with SMEs, which resulted in the SME Linkage Law of 1975. The law encouraged long-term subcontracting between large firms and SMEs and mergers between SMEs. The scope of linkages covered from 41 product items and 157 SMEs in 1970 to 71 items and 263 SMEs in 1980. According to Korea Federation of Small and Medium Business (KFSMB), the Economic Planning Board and Ministry of Commerce and Industry pushed the policy further in 1988, linking vertically 323 large firms and 2,060 SMEs covering 43 sub-industries and 1,199 items (KFSMB 1989). A recent study shows that 74.4 percent of SMEs depend on subcontracted production in 1997 and the dependency amounts to 95 percent of their sales (Chamyeo Yundae 1999: 457). Although the Korean government tried to protect SMEs vis-à-vis big business from unfair contracts via the Fair Trade Law and Fair Subcontracting Law, conventional transaction practices often prevented weak SMEs from suing big business. When they took legal action, big firms often took advantage of those subcontractors by requiring more precise quality tests, threatening transaction termination, and suspending settlement day.

Another SME policy in Korea concerns their access to financial resources. In the early 1960s, the Park government pursued somewhat populist policies of industrialization and thus created the Medium Industry Bank (later renamed Medium-Small Industry Bank) in 1961 and the Citizens National Bank in 1963. Furthermore the government stipulated in 1965 that at least 30 percent of the new loans extended by commercial banks must go to small industries (Ho 1980: 98). Yet, as Korea experienced industrial deepening, SMEs' status deteriorated financially. Deposit money banks' credit to small business was 14-25% of total credit during the 1960s, and it decreased from 25 to 21% in the 1970s (Park 2002: 102). This demonstrates that SMEs' chance of getting industrial funds was limited due to the Park regime's ambitious HCI project that showered policy loans and various financial incentives of various forms into capital-intensive industries.

The successor governments under Chun Doo Hwan (1980-88) and Roh Tae Woo (1988-1993) gave small firms easier access to bank credits than before: the SMEs share of bank credits increased from 39 to 43 percent of the total in the 1980s and from 45 to 53 percent in the early 1990s. That sharp increase in the SME credit allocation resulted not just from the fact that the Chun government had to adjust the problem of chaebol's overinvestment in the HCI project which was the main source of economic inefficiency in the late 1970s, but also from the policy change requiring bankers to reserve a certain portion of industrial credit for SMEs (KFSMB 1993).

Does that mean that in the early 1990s *chaebols* had less access to financial resources, while SMEs enjoyed more benefit than before? A caveat is that chaebols came to control non-bank financial intermediaries (NBFI) as Korea experienced rapid financial liberalization in the 1980s and the 1990s. The share of commercial banks declined steadily from more than 50 percent in 1975 to about 20 percent in 1992, whereas NBFI rose from about 10 percent in 1975 to more than 60 percent in 1992 (OECD 1994: 111). Thus, one may not exaggerate the SMEs' financial status in the 1980s even if their share of bank credit increased in the period.

SMEs' interest representation was limited and their organizations had little political leverage. The number of members of SME cooperative associations at the national level increased from 117 in 1962 to 176 in 1967, although the number stagnated during industrial deepening in the 1970s, 175 in 1972 to 177 in 1977. The number started to grow thereafter as the successor government streamlined the HCI projects, from 193 in 1982 to 338 in 1987 to 710 in 1997. Nevertheless, the increase of SME associations' members after the 1980s did not mean more organizational density. The Korea Federation of Small and Medium Business (KFSMB), a SMEs' peak organization, covered only about 12.3 percent of the total small firms and 1 percent of the total non-manufacturing small firms during the 1990s. Their membership fees constitute less than 5% of the Federation's annual budget (Park 2001: 858). An official of KFSMB commented on the status of SMEs' interest representation (interview, summer of 2002, Seoul, Korea).

> In Japan, SMEs were well organized and thus the Liberal Democratic Party (LDP) tried to coopt them under electoral competition with communist and socialist parties. The LDP provided various kinds of funds and favors to SMEs through Japan Council of Chambers of Commerce (JCCC), the urban equivalent of the rural Agricultural Cooperatives (*Nokyo*)… In contrast, SMEs in Korea employ almost two-thirds of workers, but their interests are not represented in national political scene simply because they are weak in terms of organization and financial resources that they can mobilized… As you sometimes see from newspapers, several SME businessmen have committed suicide because their firms usually were under pressure of debt service and poor operation... Politicians often try to listen to SMEs only when they do election campaign. After that, they just disappear. In this situation, it is rational for SME businessmen go to big firms for subcontracting rather than making efforts to organize their own interests. Even in this case, they are often subject to inappropriate practices that big firms impose onto SMEs.

Taiwanese SMEs: An Army of Ants in the World Market

SMEs in Taiwan have operated within a network of subcontracting relationships interwoven between firms of different sizes both vertically and horizontally. When a large-sized firm receives an order from foreign buyers, it usually subcontracts these jobs to small firms, which then usually work a single stage of processing or manufacture individual parts. The big parent firm assembles them into a final product. This inter-firm relationship is a vertical one.

On the other hand, different sizes of firms can also cooperate horizontally. They work together to produce a part or a product to fill a big order. When one company receives an order that exceeds its capacity, it subcontracts part of that order to other firms in the same business. This subcontracting relationship can be reversed when the next order goes to another firm in the network. The network system has an advantage in that "it pools each SME's limited resources to complete large production tasks" (Hsueh, Hsu, and Perkins 2001: 94). Describing Taiwanese SMEs as an "army of ants," the *Economist* (Nov. 7, 1998) described the structure on the island as follows:

> The great thing about [Taiwanese] SMEs is that they are infinitely flexible. They can switch businesses as market conditions dictate. Because

> they are small, they must find niches, avoiding the competition instead of outgunning it. Because they are numerous, corporate Taiwan as a whole is good at exploiting most of the niches in a particular industry, collectively creating a critical mass, or "cluster economy," that makes up for the marketing inefficiencies of each undersized member. And because the business network in Taiwan is so dense, local subcontractors can usually be found for everything a particular firm needs to produce its specialty, making Taiwanese companies models of sticking to their "core competence.

According to an OECD study, there are various ways for SMEs to survive in a national economy in relationship to large firms. Those strategies are technology transfer (Ireland and Spain), subcontracting (Germany and Japan), or forming larger groups or networks of SMEs (Denmark, Italy, and Finland). Korean SMEs can be classified as a subcontracting system due to the *chaebol*-led vertical linkage. Taiwan's SMEs fit into a network style as they were successful in "balancing the SME's natural desire for independence with incentives to encourage more co-operative approaches to the international economy (such as networking, clustering, joint venturing, etc)" (OECD 1997: 97). Taiwan, the kingdom of SMEs, can be compared to Italy that Piore and Sabel (1984) acclaimed for an SME network of flexible specialization. Taiwan and Italy are only two of the economies the OECD (1997: 78) report covered where SMEs account for more than 50 percent of total exports (53 percent for Italy and 56 for Taiwan). A political economist commented as follows.

> SMEs in Taiwan feature flexible management and network of cooperation. They often form vertical alliances with big firms, although their subcontracting relations usually differ from hierarchy. Even if big firms have some leverage to make their subcontractors subject to its order, they usually do not exploit SMEs' weakness but cooperate with their subcontractors so the whole production goes smoothly. (interview, summer of 2003, Taipei Taiwan)

Who played the role of coordinating the "army of ants" to export to the foreign market? In other words, given that exploiting the world market requires skilled entrepreneurship and costly information gathering, how many small family firms could market their products without being integrated into big business, as they are in Korea?

Interestingly enough, Taiwan failed to establish general trading companies (GTCs) that are often regarded as essential for coordinating export production and gathering information about volatile world markets. Japan and Korea, on the other hand, succeeded in doing so via *sogo shosha* and *chonghap sangsa*, respectively. The Park government, obsessed with export promotion as a substitute for political legitimacy, offered substantial subsidies and incentives to chaebol-owned GTCs to reduce the risks incurred from ambitious HCI programs. The growth of GTCs was spectacular. Total exports for 1975 were valued at U.S.$ 5.4 billion with the GTCs handling less than 14 percent of the total. By 1983 exports were valued at U.S.$ 24.2 billion with the GTCs handling 51.3 percent of the total (Cho 1987: 55).

Fascinated by Korean GTCs' success, some economic bureaucrats in Taiwan launched GTC projects in the late 1970s which fizzled out. They averaged only 0.82 percent of total trade in 1980 and 1.15 percent in 1983 (Cho 1987: 62). Haunted by its failure in mainland China, the KMT government feared the possibility that big private businesses could rise to power via GTCs. Nationalists knew that *sogo shosha* and *chonghap sangsa* contributed to Japanese regrouped *zaibatsu* and Korean *chaebol*. What was their solution?

> The government invited multinational, especially Japanese, GTCs and importers from export markets causing most SMEs to concentrate only on manufacturing without bothering to market their products. In 1978, Japanese and American trading companies accounted for 65 percent of Taiwan's total trade volume, and 60 to 70 percent of exports by SMEs. Domestic GTCs only offered their services in terms of communication and paper work and did not realize the real function of marketing.(Cho 1987: 59)

In this way, the Nationalists achieved the double aim of restraining big private capitalists and fostering internationally competitive SMEs.

Did the SMEs have full access to financial resources? True, they were disadvantaged compared to SOEs and *jituanqiye* when asking for industrial funds at risk-sensitive commercial banks that usually required collaterals for loans. Nonetheless SMEs did receive special financial treatment. "Funneling low-cost bank loans to the export sector where small firms thrived, the KMT government established eight SME banks by reorganizing savings and loan companies" (Park 2001: 854): the Medium Business Bank of Taiwan (MBBT), Taipei Business Bank, and Medium Business Banks in Hsinchu, Hualien, Kaohsiung, Taichung, Tainan, and Taitung. SME banks were legally required to extend at least 70 percent of their total loans to SMEs. The requirement was strictly observed: their loans to SMEs were 78.1, 75.7, and 72.6 percent of total loans in 1987, 1988, and 1989, respectively. Furthermore "the SME share of Taiwan's outstanding bank loans steadily increased to almost 40% by 1988" (Park 2001: 855). The share was considerable considering that the KMT government was reluctant to allow NBFIs to enter the financial realm, and thus to let commercial bankers prevailed in the market.

The state-owned MBBT, the flagship of SME banks, offered strategic industry loans as well as many preferential loans to SMEs, such as SME Development Loans and three Sino-American Fund programs. The former accounted for 92 – 93 percent of total loans by the eight SME banks during 1980s. A variety of additional aid programs were in operation beginning in 1967 when the Executive Yuan pronounced Regulations Governing Assistance to SMEs as a policy guide through which the Ministry of Finance could create organizations such as the SME Credit Guarantee Fund, and the Small Business Integrated Assistance Center (Yang 1994: 309-10).

It should be noted, however, that SMEs as well as big business were not as politically influential as they were in the economic realm. Since the 1950s, most business associations were penetrated by the KMT party cells, various security agents, and bureaucratic persuasion. In addition, the export sectors consisted of a large number of SMEs which typically lacked the necessary resources and skills for organizing group-based action.

Another factor contributing to weak SME's interest organization was the KMT's long-established policy of low entry barriers and exit costs. "Firms moved in and out of a given sector with ease, which encouraged private adjustment instead of collective bargaining and thus created the free-rider problem detrimental to effective collective action"(Chu 1994: 120). Thus, in 1997, Taiwan's SME peak organization had only 14 local member associations and has yet to reach 2,000 member companies (Park 2001: 863).

Another feature of SMEs in Taiwan is that they are more dispersed throughout the island than their Korean counterparts. In Taiwan, the rural shares of manufacturing firms in the size categories 50 – 99, 100 – 499, and 500+ workers were respectively 49, 49, and 46 percent in 1971. By contrast, in Korea the rural shares in the same categories were 37, 28, and 21 percent in 1975 (Ho 1982: 981). Dispersed SMEs in Taiwan contributed to a narrowing rural-urban income gap since those firms in small rural towns absorbed seasonally idle labor and provided non-agricultural income to farmers. The average ratios of rural to urban income were 0.71 for Korea and 0.81 for Taiwan during 1978-90 (World Bank 2003).

III. The Financial Sector

Korea and Taiwan, two successful late-late industrializers in East Asia, experienced roughly the same level of financial development. One indicator of this is the level of financial intermediation ratio measured by the ratio of total (i.e., personal and corporate) financial assets to the GNP (Hugh 1994: 325). In other words, this indicator measures how many economic transactions occur via institutionalized financial intermediaries. As Figure 3-1 shows, financial deepening in Taiwan steadily increased while the growth of the Korean financial sector followed a stop-and-go pattern (i.e., rapid deepening in 1965-70 and stagnation in the 1970s and then smooth deepening after the 1980s). Generally speaking, Taiwan's financial sector has benefited from high rates of savings and the low inflation that the KMT government eagerly supported. Thus the Taiwanese had an incentive to deposit their money in financial institutions, making the financial sector develop at steady rates.

In the case of Korea, the Park government, suffering from a lack of investment funding, launched interest rate reforms in 1965 to induce money flow into banks. The remarkable reform originated from policy recommendations of the U.S. Operations Mission to Korea. The reform doubled the annual time deposit rate from 14 to 30 percent and created a negative spread between commercial banks' low lending and high deposit interest rates.[8] It brought forth a rapid increase in total bank deposits in the latter half of the 1960s. As Ronald McKinnon (1973: 108) praised, the successful reform achieved "both increasing private savings and drawing private capital from the curb markets into the organized financial system."

The August 3 Decree in 1972, though, forced a moratorium on all private loans incurred by firms. The measure marked "the end of the partial financial liberalization and a complete return to the financial repression" (Cole and Park 1983: 159). The 1970s saw slightly declining financial assets due to the decree and the inflation-tolerating HCI project. High inflation rates (21 percent on average in 1970s) and negative real interest rates (-3.1 percent) made financiers and savers hesitate to maintain their accounts in banks. In the 1980s, the Chun government's market-oriented financial liberalization attracted savings into bank accounts, which contributed to Korean financial sector's catching up to the Taiwanese level.

Mobilization, Distribution, and Profitability of Financial Resources

Finance is blood containing nutrients and oxygen for industrial muscle. In pursuit of economic growth, it is important that capital-scarce governments of underdeveloped countries mobilize financial resources for certain sectors of the economy. Using finance for the purpose of industrial development entails a high price as well, turning finance into a highly politicized area. It could be a source of various of ills, including bureaucratic corruption and inefficient resource allocation. This is what neoclassical economists criticize as market-distorting rent seeking. But wisely used, industrial financing can be a efficient and powerful policy tool in drawing out business cooperation and support for government policies. Furthermore, it can encourage capital formation in an economy if it can channel citizen's money from consumption to investment activities (Cheng 1990).

In other words, financial mobilization is neither theoretically nor ideologically a "good or bad" thing. Instead it is empirically objective since almost every country, developed or not, creates what neoliberals call "rents" with varying degrees of efficiency and performance. In this sense, most less developed countries, when mobilizing financial

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[8] The recommendation was made by Hugh T. Patrick, E.S. Shaw, and John G.Gurley. See McKinnon

resources for economic advancement, have to sail between the Scylla of corruption and the Charybdis of useful financial catalyst for industrialization.

It is helpful to come up with three criteria to evaluate the experiences of financial development in Taiwan and Korea: how much capital each country's financial sector mobilized, how they distributed the resources, and how effective and profitable the allocation was.

First, the degree of financial mobilization can be measured by real interest rates, the difference between the rate of change in the GNP deflator, and the time deposit interest. The higher the real interest rate the bankers offer, the more incentive savers and financiers have to deposit their money. A more immediate proxy is the ratio of domestic savings to investment, measuring how much the government and financial sector transfer money from consumption to industry.

Taiwan was a pioneer in its steadfast adherence to a high interest rate policy to combat inflation and stimulate savings and investment. This prevented "artificially cheap capital from favoring large enterprises employing inappropriately capital-intensive technologies, a frequent occurrence in countries that suppress interest rates and ration credit"(Park and Johnston 1995: 195). The Figure 3-2 shows that Taiwan maintained positive real interest rates except in two periods of economic turmoil (1973-4 and 1979-80) following the first and second oil shocks, while the Korean financial sector experienced negative real interest rates during the first half of the 1960s, most of the 1970s, and the early 1980s. Average interest rates for the three decades were 1.1 for Korea and 6.1 for Taiwan. Korea had a relatively more "repressed" financial system than Taiwan did. As Ronald I. McKinnon (1973) put it, "in a repressed system, a government maintains artificially low interest rates. Because this induces an excess demand for credit, the government is drawn into the process of rationing financial resources among competing uses, i.e., preferential credit schemes."

Figure 3-3 shows the yearly ratio of gross domestic savings to gross domestic investment, both as a percentage of GNP. Taiwan covered its domestic investment with savings except for the years of 1974-5 and 1980 in the wake of two oil shock episodes,

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(1873: 108).

whereas Korea lacked domestic investment funds most years and thus had to resort to foreign loans and capital. Korea borrowed foreign capital that amounted to, on average, 2.5 percent of the GNP between 1970 and 1991, compared to Taiwan which exported its capital as 5.9 percent of GNP during the period (World Bank 2003). Due to the historical trauma of hyperinflation in mainland China, the KMT government was eager to sustain macroeconomic stability and positive real interest rates to increase savings. The government supported corporate financiers and individual savers by low inflation and high real interest rate to attract domestic financial resources for economic growth.

The second criterion for financial evaluation is patterns of loan distribution. In Taiwan, an industry-specific credit policy was apparent in the brief stage of ISI during the 1950s, but was soon replaced by credit policies targeted at broad goals that included export promotion, industrial upgrading, and pollution control. An industry-specific credit policy was revived in the 1980s to nurture strategic industries (i.e., information, machinery, and electronics, etc.) but the credit extension was small in size, comprising only 4.4 percent of total government loans, and constantly came under criticism from central bankers and economists. The remainder of the credit went to non-strategic industries to finance automation equipment, domestic machine production, and environmental control in various sectors (Shea 1994: 252-3).

The KMT government made considerable efforts to financially support its political coalition partners, SMEs, and farmers. Premier Chiang Ching-kuo, a political populist, explicitly endorsed special treatment for those sectors, arguing that credit allocation should be fair and reasonable. The SME credit started in the 1950s, when the Sino-American Fund financed SMEs' financial needs. During economic deepening in the 1970s, central bankers raised huge amounts of SME funds in the wake of the 1974 oil crisis and the KMT established the Medium Business Bank (MBB) of Taiwan and MBBs at six cities in 1976.

On the other hand, the agricultural sector became heavily subsidized in 1971. As a result of the new agricultural policy during the 1970s that Chiang Ching-kuo emphasized to consolidate his power in rural society, Taiwanese farmers were financially supported by rural credit cooperatives that emerged as one of the richest types of financial institution on the island. The Farmers Bank of China, Land Bank of Taiwan, and the postal savings account financially supported the agrarian people under the control of the Central Bank of China (Cheng 1993: 70).

In contrast, Korea's financial allocation was mainly in the name of preferential policy loans: its amount as a percentage of total credit was 65.2 percent in 1962-66, 44.1 in 1967-71, 53.7 in 1972-76, 57.1 in 1977-81, 55.6 in 1982-86, and 53.0 in 1987-91. The cheap credit was funneled into large capital-intensive firms: shares of HCI accounted for 74.2 percent of total investment to manufacturing in 1976, 75.4 in 1977, and 82.5 in 1978; average debt-to-equity ratios in 1976-90 were 84.7 percent for small firms, 272.9 for medium-sized firms, and 356.0 for big firms (Woo 1991: 162; Lee 1999: 409).

The third criterion is how lucrative the financial sector is in its managing of financial resources. Table 3-9 is *The Banker*'s reports about varying degrees of banking performance in the top 200 Asian banks. Total assets of those big banks in Korea are U.S.$ 310,152 million, compared to U.S.$ 222,736 million for Taiwan. The size of enlisted Korean banks is much bigger than Taiwanese ones. Twenty nine Korean banks are enlisted in the top 200 list and have the third largest assets in Asia, behind China and Australia. Indicators of banking performance, however, show the reverse. The return on capital and assets for Taiwan are 29.52 and 1.09 percent, respectively, while Korea has much lower rates, 7.84 and 0.52 percent. Taiwan's banking sector is rated 3.0 whereas the Korean sector is rated 5.0. Note that the lower index numbers signify better performance. The survey shows that Taiwan's banking sector has fewer big banks but performs better and more effectively than its Korean counterpart.

Ownership and Loan-Extending Behavior

Who are the major owners of commercial banks in Taiwan and Korea? Almost all of the banking system was state-owned in Taiwan. Of 16 domestic full-service banks, only four are less than half owned by the KMT government. Banks as SOEs held the following share of total deposits: 98.5 percent in 1970, 97.2 in 1975, 90.0 in 1980, 88.3 in 1985, and 84.0 in 1990 (Central Bank of China 1995). The private commercial banks have been in a marginal position of Taiwan's banking hierarchy because there have been many regulations against the entry of private capital into the banking system. The assets of financial institutions as a percentage of the national total in 1991 are as follows: the

Central Bank of China (20.2 percent), domestic banks (42.4), SME banks (5.8), credit co-ops (12.7), postal savings (9.2), foreign banks (2.3), and other insurance/trust companies (7.6) (Central Bank of China 1992). Financial institutions beyond the KMT government's control are the last two institutions comprising only 9.9 percent of the total assets. Non-bank financial institutions (NBFIs) are not yet developed in Taiwan mainly due to deliberately slow financial liberalization.

Interestingly enough, the KMT leadership had a "preference order" granting banking permission to newcomers. Nationalists would do their utmost to expand the state sector before considering any new private institutions. If it was not feasible, they granted permission in the order of foreign banks – overseas Chinese banks – domestic private financiers. What is the order for?

> First, foreign banks were politically safe and not predisposed to challenging the legitimacy of the regime. In addition, the KMT needed foreign banks that could compensate Taiwan's diplomatic isolation from international society with their presence in the island. Second, new banking licenses were a reward for overseas Chinese political support of the KMT regime. Overseas Chinese capitalists could threaten to switch loyalty from the KMT to the Chinese communist regime. Also, they could be an "offshore opposition," freely criticizing the KMT. Last, indigenous private capital was allowed to enter the financial realm only in credit co-ops, provincial banks for SMEs, and trust/investment companies. Their market share was small and the operations of these institutions were highly restricted by the KMT. (Cheng 1993: 75-7)

What the KMT government aimed at was to discourage native Taiwanese industrialists from entering the financial sector and growing into industrial-financial giants threatening the émigré regime's political dominance. As Tun-jen Cheng put it, "the preference order was less a function of their economic value than of political risk and the bargaining power the three groups of capitalists possessed vis-à-vis the KMT regime"(Cheng 1993: 75).

The Korean banking system was privatized in the early 1980s when the Chun government launched financial liberalization. According to a study (Park 1994: 185), assets at financial institutions as a percentage of the total in 1990 are as follows: commercial banks (31.0 percent), specialized banks (11.8), developmental banks (8.0), investment companies (13.3), credit unions and co-ops (24.0), insurance company (7.5), securities companies (4.6). Here, government-owned financial institutions are only specialized and development banks, both of which constitute merely 19.8 percent of total asset in financial market.

Who then are the dominant owners of the financial realm in Korea? If one looks into the shares of financial intermediaries, (s)he will find that the share of commercial banks has been steadily declining from more than 50 percent in 1975 to about 20 percent in 1992, whereas the share of NBFI has been rising from about 10 percent to more than 60 percent in the same period (OECD 1994: 111). It should be noted that *chaebols* own large NBFIs that in turn invest their money into big commercial banks as major shareholders. For example, the Samsung Group controlled as a major shareholder twelve nation-wide banks and seven local banks by 1997. Top 5 chaebols (Samsung, Hyundai, Daewoo, LG, and SK) owned 32.1 percent of the securities market, 35.6 percent of the life insurance market, and 13.7 percent of merchant banks by 1996 (Lee 1999: 351).

Why did the chaebols not own commercial banks directly? Commercial banks were bound to comply with the Bank of Korea's guidelines on the aggregate money supply, reserve ratio, and banking operations, and thus could not extend credit to private firms at their discretion. Thus chaebols decided to bypass the regulation: they entered non-bank financial businesses from which they could secure industrial funds and influence the banking sector in their favor. Chaebols constructed an empire dominating both finance and industry.

Different patterns of loan-lending behavior contributed to different profitability of loan extension in the countries. In Taiwan where most of the banking institutions were state-owned up to the mid-1990s, individual bank officers are, by definition, civil servants facing administrative sanctions and even criminal punishment for any non-performing loans. Thus they meet strong disincentives against risky lending. The bank officers allocate funds based on the consideration of security (i.e., collateral), not the rate of return. The concern over possible personal liability for bad loans makes bank officers risk-averse. An American banker (Ralp 1970: 11-2) complained about their strict practices at bank windows:

> [Bank] employees are judged by agencies, on their ability to avoid mistakes rather than upon their exercising authority, making decisions, or making other important contributions to the banks. Thus imagination, initiative, and decision making tend to be discouraged. Thus if he had a cash shortage of US$10.00 or US$50.00 his career may be jeopardized and the bank may lose the full services of someone capable of satisfactorily fulfilling senior level responsibilities. In the United States it is expected that people will make mistakes and we use experience to estimate potential losses and then figure the cost of manpower, if a system is developed to reduce those losses.

In Korea, however, banks considerably relaxed their policy of requiring collateral. Bankers extended loans to creditees without collateral if the loan applicants had a promising business plans. The share of deposit monetary banks' loans that was extended without real assets, deposits, and other forms of collateral was 26.5 percent of the banks' total credit in 1970, 34.9 in 1975, 30.8 in 1980, 43.8 in 1985, 49.2 in 1987, and 46.7 in 1989 (Park and Kim 1994: 206). When banks accumulated nonperforming loans, the government grudgingly intervened to turn bad loans into equity, rescheduled them, or provided the additional new loans needed to meet repayments. Given that it is the government that has been ultimately responsible for credit allocation decisions, the problem of moral hazard on the part of commercial banks has been serious. A senior official (interview, summer of 2003, Seoul, Korea) of Financial Supervisory Commission commented:

> They [bankers] used to be risk-taking in loan extension since they expected the government would intervene between the concerned banks and the debt-ridden big firms. In a way, the state deprived bankers of a chance to take prudential banking into account. Late setup of the Korea Deposit Insurance Corporation in 1996 reflected bankers' lack of attention to risk in financial business.

IV. The Agricultural Sector

The fact that two poor agrarian societies after the Second World War experienced miraculous late-late industrialization suggests that their agricultural sectors were undergoing a transformation. Farmers in Korea and Taiwan constituted 83.1 and 76.1 percent, respectively, of the total employment in 1930 but they were 6.4 and 6 percent in

2005. How did farmers and agriculture sail in the storm of such rapid urbanization and industrialization in both countries?

Rural and Urban Bias in Industrialization

The Japanese empire colonized both Korea and Taiwan mainly for cheap agricultural products, especially rice and sugar cane, so the colonies were heavily agrarian societies dominated by feudal landlord / tenant relations. After World War II, new governments in those three countries rammed through land reform under the guide of the American hegemon in the late 1950s and early 1960s. It was a revolution from above and without. Destroying the landlord class and traditional elites anxious to protect plantation and tenant system was a great measure that eased the transition to an industrial society, which is a rarity in the Third World.

Although sharing the initial condition of land reform, the two developmental regimes were different in accommodating the interests of farmers and the agricultural sector in their industrialization process. As Taiwan's balanced and stability-oriented coalition and Korea's unbalanced and growth-oriented coalition suggest, the two governments developed agriculture, infrastructure, and industry in different sequences. Taiwan followed the sequence of "first developing its agriculture and rural infrastructure and then rapidly expanding its industrial sector with the help of resources (labor, savings and foreign exchange earnings) diverted from agriculture" (Ho 1982: 983). In Korea, on the other hand, "rural transformation has followed and been caused by industrial and urban development rather than the reverse" (Mason et al. 1980: 210).

Institutional support and development priorities have clearly benefited agriculture more in Taiwan than in Korea. Although the agricultural sector was relatively smaller in Taiwan, fixed investment in agriculture averaged 20 – 30 percent of total fixed investment in the 1950s and 15 – 20 percent during 1960s. The share in Korea was only 10 to 15 percent during these years. Furthermore, rural electrification began relatively early in Taiwan, and by 1960 electricity reached 70 percent of its farming households. In Korea, only 13 percent of farming households had electricity in 1964 (Ho 1982: 983-4). Although retarded rural development in Korea was mainly due to national destruction from the Korea War (1950-53), basic developmental priorities in the countries were different.

According to Lipton and Bates, urban bias is prevalent in developing countries, an important drag on overall economic performance, and a cause of economic inequality (Lipton 1977; Bates 1981). Taiwan was an exception. The KMT regime intentionally implemented a rural-to-urban spillover policy to consolidate its power in an alien rural society, while authoritarian governments in Korea followed the path of urban-to-rural spillover to secure industrial growth as soon as possible under the condition of periodic electoral competition with opposition parties. Table 3-10 is about sectoral allocation of U.S. aid, which shows how the countries supported agricultural development in the 1950s and 1960s when U.S. aid was actually an economic lifeline to both poor and small countries.

The KMT government allocated 21.5 percent of the total U.S. aid for agriculture while Korea used a meager 4 percent for the sector. Korea spent more American aid on infrastructure, mining, and manufacturing. Commentators criticized the urban bias in Korea's economic development by saying that "except for land reform in the late 1940s and the early 1950s, the government's attitude toward farmers could be described as basically one of neglect prior to the 1970s" (Mason et al. 1980: 241).

Figure 3-4 demonstrates how the two countries accommodated farmers' interest while pushing export-oriented industrialization. It details the farmers' balance sheet between income from agricultural products and the production costs incurred on the basis of the price index with 1990 being the base year. Generally speaking, Taiwan's farmers have gained from the late 1950s to the late 1990s, with some exceptional years. Korean farmers sold their products to urbanites at a loss, except in the 1970s. The average balance for Korea and Taiwan is -0.6 and 0.8, respectively, in 1959 – 70, 0.67 and 2.87 in 1971 – 80, and -3.34 and 2.84 in 1981 – 94. The cumulative balance amounts to -47.1 for Korea and 80.14 for Taiwan.

A commonality of agricultural policies in Taiwan and Korea is that both governments during the 1970s embarked on a dual price system where they purchased rice from farmers at a higher price and then resold it at lower price to urban consumers.

Why did political leaders in both countries launch such programs resulting in a fiscal deficit?

In the case of Korea, the Park government was surprised to see a decline in rural political support in the 1971 presidential election. Thus, launching two subsidy programs, the Grain Management Fund and Fertilizer Account, the government increased its purchase of rice from farmers and allowed them to receive average annual grain price increases of 20 percent during the 1970s, a time when the country was losing its comparative advantage in agriculture (Haggard and Moon 1990: 222). As one can see from figure 3-4, Korean farmers' balance sheet of producing rice turned positive for the first time; figure 3-5 shows a rapid increase of rice price after early 1970s. Note that cross-country comparison by the figure 4-6 is not appropriate due to different production costs in the two countries.

Taiwan has a similar story. The KMT government launched the New Agricultural Policy (NAP) in the early 1970s when Chiang Ching-kuo, a Taiwanese-oriented populist, assumed control of economic policy as premier. He emphasized the popular sectors such as SMEs and agriculture to consolidate his political succession to his father, Chiang Kai-shek. He dramatically increased the amount and price of rice purchased, turning agriculture from an export sector to a subsidized one. Figure 3-4 shows a sharp increase of the farmers' balance in the late 1960s and mid-1970s. Figure 3-5 also indicates that the KMT government paid more than before when purchasing rice from farmers.

Unfortunately, the rural bias of the 1970s did not last into the 1980s in Korea. The authoritarian Chun government, the successor of the Park regime, lacked political legitimacy since he came to power in a military coup in 1979-80. He needed political backing from U.S. allies who were eager to pry open the highly protected agricultural sector in Northeastern Asian countries. Furthermore, the government's policy priority was to streamline the Korean economy to cure overinvestment, inflation, foreign debts, and fiscal deficits that had originated from overheated HCI in the 1970s. Thus, fiscal deficits from the dual rice price system were a bête noire in the eyes of neoliberal technocrats who decided to open the domestic market to American agricultural exporters. As figure 3-4 shows, farmers in the 1980s suffered from trade liberalization that caused their balance sheet to sharply turn negative.

In contrast, the Nationalist regime was politically stable well into the 1980s with insignificant challenges from a newborn opposition party. The KMT government was reluctant to increase American agricultural imports considering its social base in the rural society. They chose to increase non-agricultural imports from the U.S. protecting the farmers' interest in the domestic market. Furthermore, the Nationalists kept subsidizing farming households in the 1980s. As figure 3-4 shows, the average ratio of rural to urban income in Korea in 1978-90 was 0.71, while the ratio for Taiwan was 0.81.

Government Institution and Farmers' Organization

Governmental agricultural agencies in Korea were the Office of Rural Development (ORD) and Ministry of Agriculture and Forestry (MAF). The former is basically a farming technology research institute and did not enjoy policy making authority (Brandt 1980). The latter is the ministry of all agricultural affairs, although its minister did not enjoy policy autonomy from the economic control center, EPB. An MAF minister was considered a marginal position in cabinet, inferior to ministers of industrial and financial affairs. This inter-ministry status reflected an urban bias in the economic development of Korea.

Interestingly enough, Taiwan has not had a formal Ministry of Agriculture (MOA) (Moore 1993: 109). The Sino-American Joint Commission on Rural Reconstruction (JCRR; 1948-79) played the organizational substitute of MOA. Chastised by the consequences of its neglect of agriculture and peasants on the mainland, the Nationalist government abolished the MOA, assigned all agricultural affairs to the JCRR, which was originally initiated in the form of the American China Aid Mission. Although the JCRR was subordinate to the Executive Yuan (i.e., cabinet), it enjoyed great autonomy in policy making and implementation because the authority was delegated to the director of the Agency for International Development (AID) in Washington, who exercised policy discretion and fiscal control over the JCRR (Shen 1970: 27-28). The American hegemon itself took charge of agricultural policy in cooperation with the KMT officials.

As a well-funded and flexible organization with autonomous and supra-ministerial status in government, the JCRR was able to exert strong influence on policies by governmental and nongovernmental organizations at the national, provincial, and county levels. With its focus on rural reconstruction, the JCRR provided a broad vision of the integration of policy formulation and implementation. This integrative role extended beyond agriculture to agriculture-related industries and rural health (Park and Johnston 1995: 200). It was the JCRR that introduced incentives for SMEs to embark on their business in small towns and counties so that farmers could commute to factories earning extra-farming income especially during idle season. Praising the JCRR's performance in developing agriculture and enhancing rural life, Kuznets argues that the JCRR is the institutional factor that differentiates Taiwanese from Korean agricultural policy (Kuznet 1980: 58).

In comparison, the KMT government managed to take care of farmers and agriculture, while the Korean government did not. This statement, though, does not mean that farmers in Taiwan were more influential as an interest group in politics than those in Korea. The autonomy and power of the farmers' associations were severely constrained in both countries.

In Korea, the Park government integrated the Farmers Bank into National Farmers Cooperatives (NFC) to control the agrarian society in 1961. The speed and scope of the state's penetration into rural society was striking; NFC units at the sub-county level increased from 895 in 1960 to 21,518 in 1962, covering 90 percent of all farming households (Byun 1995: 46). The Park government revised the NFC law so the Ministry of Agriculture and Fishery could nominate the NFC chairman and supervise the association. It was illegal for the NFC to participate in any type of political action. On the other hand, the NFC was allowed to enjoy legal and actual monopolies to distribute major agricultural inputs (i.e., fertilizers, insecticides, farming machines, seeds, and fodder) and to collect major agricultural products from farmers and sell them in the urban market (National Farmers Cooperatives 1991: 978-9). In sum, farmers in Korea were organized into the "state corporatism" (Schmitter 1979) in the sense that the NFC and its local branches exchanged their loss of associational autonomy for a monopoly on profitable agriculture-related businesses.

The KMT government reorganized the Farmers Association in 1950, largely along the lines recommended by Professor Anderson of Cornell University. Thus the associations were engaged in a very wide range of income earning activities, including processing, storage, and distribution of agricultural products, rural credit business, grain procurement, agricultural insurance, supply of agricultural inputs, and the collection of land tax. But the government rejected some aspects in the professor's report which would have given the associations considerably more autonomous economic power and organizational coherence (Moore 1993: 103-5).

The Provincial Farmers Associations had a high proportion of mainlanders on their staff and were obliged to employ the KMT and political intelligence *apparatchiks* in their security departments. In 1974 the government introduced a range of measures to assert even more direct control over the Association. In particular, chief executive officers, even at the level of the township Farmers Associations, were to be directly nominated by the state, rather than chosen locally by members' representatives (Moore 1993: 103-5). In summary, farmers in Taiwan were more accommodated economically in industrialization than their Korean counterparts, although they were not allowed to voice their own interests or organize themselves with autonomous associations in either country.

V. Labor and Political Demobilization

Theoretically speaking, import-substitution industrialization (ISI) encourages a stimulation of domestic purchasing power to support industrial development, and thus it partially mutes the contrary pressure from employers to restrict labor costs, justifying government efforts to increase welfare expenditure by firms. According to Deyo (1987: 183), this linkage between domestic purchasing power and industrial production was weaker in the case of export-oriented industrialization (EOI) where, by definition, immediate consumers are foreign buyers.

The theory suggests that Korea and Taiwan, small open EOI economies, register repressive labor policy to keep labor costs low and keep workers disciplined and compliant, which is the way the countries' products remain competitive in the foreign market. Figure 3-6 shows weekly working hours in Korea, Taiwan, and other countries, which suggests that although Taiwanese workers consistently worked less than Korean counterparts, both countries resorted to more input of cheap labor to sustain the EOI strategy than other comparable countries did.

History shows that both governments feared workers' politicization mainly due to the two nations' struggle against labor-friendly communists during the state building process after the Second World War. Crossing the Taiwan Strait, Nationalists brought with them most of the repressive labor legislation, especially the Labor Union Law of 1929,[9] enacted in the mainland context of protracted civil war. In addition, the martial law after the KMT's relocation to the island banned strikes of any type by compulsory arbitration of industrial conflicts, restricted wage bargaining by unions, and subjected all unions to supervision by local governments. Local security units determined if a union was politically and ideologically legitimate, supervised their daily operations, and sometimes directly assumed the union leadership role.

On the other hand, the KMT government was eager to coopt workers in its favor. Unions were strengthened by the requirement that workers had to join a union where one already existed, subject to the penalty of loss of employability in the relevant industry in the case of refusal to join. Under the 1932 Factories Act, large enterprises were required to establish factory councils consisting of representatives from labor and management. Employers were also obligated to provide welfare, housing, and educational and other forms of employee assistance (Deyo 1987: 184; 1989: 117). In a nutshell, Nationalists wanted to disintegrate proletariats and then *re*organize them in the name of the 'people' with some preemptive measures and material benefits.

The Korean labor regime also registered the depoliticized mobilization of workers. Right after his coup of 1961, General Park refurbished the Federation of Korean Trade Unions (FKTU) with an industry-based union system organizing workers into a "state-corporatist scheme" (Schmitter 1979; Choi 1988). The Yushin Constitution "revitalized" the labor-repressive regime in Korea in the 1970s. It prohibited strikes altogether in the state sector, public enterprises, local government, utilities, and any

[9] The KMT was affected by Sun Yat-sen's *Minsheng* Principle that, in a way, connoted struggle against the working class. When he criticized Marx but praised Bismarck's welfare dictatorship, he devised the Principle for rapid industrialization from above without being trapped by class struggle, which is typically found in corporatist and Fascist thinkers. The principle served as an antidote to the spirit of class. See Sun, Yat-sen (1927: 396-398); Schmitter (1979); and Moore (1966: 187-201).

business that affected the national economy in important ways. In addition, a 1973 amendment to the Labor Disputes Adjustment Act prohibited any collective bargaining without prior Labor Committee certification of legality. The same law gave the Office of Labor Affairs substantial supervisory authority over the Labor Committee, thus interjecting direct government authority in industrial mediation (Deyo 1989: 136).

Figure 3-7 shows unionization rates in both countries since 1961. Prior to the 1980s, the Park government mobilized two times more workers into the state corporatist scheme than the KMT did. The average unionization rate as a percentage of the total employed workforce was 21.6 for Korea and 11.5 for Taiwan before the 1980s.

Political liberalization and democratization in mid-1980 gave workers a chance to organize themselves. When the June Uprising, activated by democratic oppositions, students, and urban middle class, made democratic transition possible in Korea in 1987, urban workers were reactivated, going on massive strikes especially from July to September of that year. It was a big bang. The number of industrial strikes skyrocketed from 276 in 1986 to 3749 in 1987, working days lost from 72,000 to 6,946,935, and workers involved from 46,900 to 934,900 (National Statistical Office 1995: 401). As Figure 3-7 shows, worker's union membership increased after the 1987 democratic opening but decreased sharply in the 1990s. Why did Korea not experience institutionalization of labor politics even after political democratization?

Post-democratization governments, despite democratic achievement in some areas, sustained a labor-repressive stance by "stabilizing" the overheated labor movements and arresting more union activists than the previous authoritarian governments. On the other hand, the Korea Employers Federation (KEF), the employers' peak organization, launched new managerial strategies including reinforcement of labor control, market-oriented flexible employment, and rationalization of production. For example, unions were influential at the factory regime since union staffers were often senior workers and thus head of operation units. But after the adoption of new managerial rationalization, senior workers became dependent on high production technology which deprived them of industrial authority at the production line. They had to tolerate the deskill process to secure their job, which contributed to the unions' influence being diminished in the factory regime (Choi 1993: 263-91; 1996: 319-357).

Workers in Taiwan also started to organize in the mid-1980s as the first official democratic opposition party, Democratic Progressive Party (DPP), formed in 1986 and the forty-year-long martial law was lifted on July 15, 1987. As Figure 3-7 shows, unionization rates increased from 18.7 percent in 1981 – 85 to 24.3 in 1986 – 87 to 30.2 in 1988 – 90. Taiwan's rate of unionization became higher than Korea's after 1983. Does this mean Taiwanese rank-and-filers were more organized than their Korean counterparts? It should be noted that post-democratization organizational power cannot be judged by merely reading the data. It is generally recognized that Korean workers are better organized and militant than their Taiwanese counterparts. It should be noted that much of the growth in union membership on the island was concentrated in occupational unions, rather than industrial ones. A Taiwanese scholar (Chu 1996: 499) commented about the occupational unions as follows:

> Since the early 1980s the KMT government has significantly relaxed the process of licensing newly established occupational unions especially for taxi drivers, small traders, and self-employed workers. Since the government did not specifically require occupational unions to verify their members' working status, many people, working or not, joined an occupational union to get benefits from the state-sponsored health insurance. Moreover the KMT employed preemptive measures to encourage its members to found unions and seize leadership posts. In this sense, when the occupational unionization is discounted, the actual level of unionization in 1992 is no different from that of 1987.

Difference of Labor Politics: Socio-Economic Variables

Statistics show that the average number of workers involved per industrial dispute during 1961 to 2000 is 446 for Korea and 34 for Taiwan (National Statistics Office 1995: 399). Why are Korean workers more militant and organized than Taiwanese ones even if the populations of both countries are considered?[10] According to Aristide Zolberg, national variations of economic and political structures contribute to different working class formations in each country. Economic structure can be thought of as a combination

[10] Labor force in industry in 2000 is 6.2 and 3.8 millions in Korea and Taiwan, respectively. Korea has 1.63 times more workers than Taiwan. CIA, Word FactBook (https://www.cia.gov/c ia/publications/fact book/index.html). accessed Sept. 13, 2006.

of several variables, including the 1) extent of industrialization; 2) the degree to which the industrial sector is capital intensive; and 3) the mechanism for procurement of industrial labor force (Zolberg 1986: 430-3). I'll discuss these two countries in that order.

The two Asian NICs are similar in their levels of industrial development: sectoral contributions to GDP in Korea of 1995 are 5.7 % by agriculture, 37.7 by industry, and 56.5 by service; in Taiwan those in the same categories are 3.5 %, 36.4, and 60.1.

But the capital-intensiveness is a very different story. Launching industrial deepening in the 1970s and 1980s, developmental governments in Korea funneled financial resources into capital-intensive heavy chemical sectors (shipbuilding, steel, petrochemical products, and machines), sacrificing agricultural and SME sectors. Predominance of chaebols in the sector contributed to larger unions, more membership of male workers, and more organized and disciplined workers in Korea. The working class formation in Korea was more rapid than in other early developers of the western world since rapid industrialization means rapid working class formation (Choi 1988).

Although Taiwan also experienced a rapid industrial transformation as Korea did, the backbone of its national economy are the SMEs, rather than big business, that specialize in less capital-intensive products such as electronics, computer, and auto parts. This SME dominance contributes to smaller union size, lower membership of male workers, and serious problems for orchestrating collective action among regionally dispersed small firm workers. A scholar (Huang 1997: 7) commented on SMEs' unions as follows:

> Many members of the occupational unions in Taiwan joined for the health insurance. Among these so-called occupational workers, many are self-employed professionals or entrepreneurs of small and medium-sized enterprises. Since members of the occupational unions are generally indifferent, if not opposed, to the interest of the working class, this is damaging to the labor movement. Even more frustrating for industrial workers is that, at the regional and national federation level, elected union officials are usually from the occupational unions. This is so not only because the number of occupational unions usually far exceeds that of the industrial unions, but also because leaders of the occupational unions tend to be members of the ruling party [KMT] or have close ties with it.

Table 3-11 shows the enterprise structure in Korea and Taiwan. Obviously, large firms employing more than five hundred workers dominate the Korean manufacturing sector. They hire 32.1 percent of the total employees in the manufacturing sector and produce almost half of the total production. In contrast, Taiwanese firms in this category hire 15 percent and produce 26.8 percent of national wealth.

The national variations in industrial structure contribute to different patterns of labor disputes. Table 3-12 proves that the "small number of big unions" in Korea and "large number of small unions" in Taiwan affected different pattern of industrial disputes. Although Korea had fewer industrial disputes than Taiwan (A columns), Korean unions mobilized more workers to disputes than Taiwanese unions did (C columns). A caveat is that Korean workers are more than Taiwanese ones: labor force in industry in 2000 is 6.2 and 3.8 millions in Korea and Taiwan, respectively; Korea has "1.63" times more industrial workers than Taiwan. But the average number of workers involved per dispute in 1961 – 2000 is 446, the number of the same category is 34 in Taiwan; the number of Korean workers participating in disputes is "13.1" times more than that of Taiwanese workers. It is clear that Korean workers are more densely organized and militant than their Taiwanese counterparts when discounting differential number of workers.

Different mechanisms for procurement of industrial labor force also effected different patterns of working class formation in the countries. In Korea, urban manufacturing industries have been the main sites of working class formation. Due to the small-holder structure of Korean agriculture and the underdevelopment of rural industries, Korean working class formation started from a large-scale rural-to-urban exodus (Koo 1990: 675). City dwellers in total population changed from 33.6 percent in 1966 to 57.3 in 1980 to 74.4 in 1990. This increase is more rapid than in Taiwan where urbanites were 31 percent in 1966, 47.2 in 1980, and 55.4 in 1990 (National Statistical Office 1995: 61; Executive Yuan 1991: 17).

Furthermore, those immigrants concentrated in a few industrial centers. In 1984, about half of all manufacturing workers resided in the Seoul-Kyungin area and another 40 percent in the Youngnam area in the southeast (Koo 1990: 675). "Young migrant workers in the cities were unlikely to return to rural areas. Rather, they lived in increasingly well defined, class-specific communities that divided the organizational and social lives of workers from nonworkers" (Koo 1990: 676). As Katznelson suggests, the urban-based and geographically concentrated industrialization pattern encouraged permanent migration from rural areas and full commitment to urban industrial work, thereby facilitating a full-scale working class formation (Katznelson 1981).

In Taiwan, industry developed in a more dispersed fashion with a greater share of industrial employment in rural areas, than in Korea, which is due to the early development of commercialized agriculture and of diversified agro-industry on the island. The rural shares of manufacturing establishments in the size categories of 50 – 99 workers, 100 – 499 workers, and 500+ workers were respectively 49, 49, and 46 percent in 1971. In contrast, in Korea, the rural shares in these same size categories were 37, 28, 21 percent in 1975 (Ho 1982: 981). With decentralized industrial growth, rural household members could participate in non-agricultural activities by commuting while still taking part in farm work as a sideline or during busy farming seasons. Statistics shows that the average off-farm income as a percentage of total farm family income is 33.9 percent in the 1960s and 52.2 in the 1970s. The same percentages in Korea were 16.0 in the 1960s and 16.3 in the 1970s (Oshima 1986: 804). The SMEs-based economy and rural-urban nexus contributed to a "landed" or "part-time" working class formation in Taiwan (See Gates 1979; Moore 1993; Park and Johnston 1995).

In addition it is a typical pattern in Taiwan that average workers leave factory work to marry and start their own small business after years of "selling their youth to the company." "The Taiwanese have a joke that if you throw a stone in the streets of Taipei, you are likely to hit a chairman of the board. With one company for every 18 people in Taiwan (the highest density in the world), it could almost be true" (*Economist*, Nov. 7, 1998). This class fluidity and economic overlapping among farmers, industrial workers, and SME petite bourgeoisie undermined a full-scale working class formation in Taiwan.

Difference of Labor Politics: Political Variables

Political variables also affected national variations of working class formation in the two countries. Although both countries imposed repressive state corporatist schemes that did not allow autonomous interest representation of rank-and-file workers, they were different in dealing with labor disputes. The central government in both countries wielded the most power, but Korea allowed less narrow space for local autonomy than Taiwan did. True, Korea's first local elections were not held until 1991. Before then, local officials were appointed by the central government that controlled and supervised important policy agendas in local administration. In this situation, if there happens to be an industrial strike in Ulsan, an industrial city on the Southeast coast where Hyundai Motors is positioned, central government agencies directly and immediately intervene to resolve the dispute, often with repressive measures. The local government in Ulsan hesitates to, or is not allowed to, deal with the nation-wide impact that the Hyundai dispute should have in the economy. Local disputes, especially in big businesses, tend to nationalize very fast so union activists in provinces and towns directly face hard-fisted central agencies without any buffer zones.

In Taiwan, mainlander Nationalists monopolized political society at the national level, although they allowed indigenous islanders to participate in local governments. The KMT government granted local elites regionally monopolized economic privileges in exchange for their political loyalty, and made local elections in the arena for local resource competition. Therefore, local politicians have been accustomed to providing services and responding to their constituencies (Lerman 1977). Given that the Labor Dispute Mediation Law requires labor disputes to be mediated in the jurisdiction where they occur, the county and city bureaucrats in charge of labor affairs used to play a pivotal role in solving disputes. After democratization, an increasing number of workers asked for help from their local elected politicians when they crashed against their employers, which affected the labor movement in Taiwan. The easier it is for individual workers to solve disputes by eliciting help from local politicians, the less likely it is to collectively solve the problem or link their personal grievances with those of other workers (Huang 1997: 8).

On the other hand, all the Union Federations at the county and city level received subsidies from local governments and sometimes the central government. Tainan County Federation of Unions, for example, earned 45 percent of its 1992 budget from member unions' dues, and 31 percent from the county government and the Council of Labor Affairs (i.e., functional equivalent of Ministry of Labor) (Huang 1997: 11). In this situation, unionists are less likely to militantly mobilize rank-and-file workers against governments which support themselves in financial terms. If they do, they should loose a third of their own budget resource.

More importantly, political leaders' attitudes toward workers in Korea and Taiwan have been different when they demobilized workers from politics and remobilized them into EOI industrial efforts. Korean elites have been regarding union activities as being infiltrated with communism, disturbing industrial peace, and eating away at the national wealth. This epistemology biased against workers is understandable since economic growth rather than social welfare has been the principle of political and social integration.

In contrast, the KMT leadership employed enlightened and preemptive measures to effectively co-opt threats from below so it could survive in the alien island. As the KMT has the Principle of *Minsheng* (people's livelihood) as an official state ideology, political leadership provided a relatively more "material base of consent" (Przeworski 1985: 133) to workers than its Korean counterpart did. In T.H. Marshall's terms, the Taiwanese were given socioeconomic citizenship in exchange for political citizenship (1977: 78).

It is now necessary to identify the different levels of material compensation for political demobilization in the two countries. The levels can be proxied by working hours, wage, wage differentials, unemployment, and working conditions in factories. Figure 3-6 showed that Korean workers worked more than the Taiwanese in terms of weekly hours. The average work week was 52.1 hours for Korean workers and 48.2 hours for the Taiwanese counterparts from 1977 to 1994.

Then, did the hardworking Korean workers get paid more than Taiwanese ones? Unfortunately, Figure 3-8 shows that Korean employees in manufacturing were paid less than Taiwanese ones in terms of hourly wage except for the 1977-79 periods when there was rapid wage increase due to shortage of labor force.

Figure 3-9 graphically demonstrates how much wage inequality industrial workers in two countries experienced with informative reference to advanced OECD countries. The Theil index,[11] a measure of wage gaps in the manufacturing sector, was consistently lower in Taiwan than in Korea. Taiwan's index was lower than even OECD countries except for oil shock-affected years (1974-75 and 1978-80). Note that a lower index means less wage inequality. The average Theil index between 1973 and 1997 was 0.026 for Korea, 0.016 for Taiwan, and 0.018 for high-income OECD countries.

Another indicator of worker's welfare is unemployment rates which is displayed in Figure 3-10. Average unemployment rates between 1963 and 2000 are 4.22 percent in Korea compared to 2.08 in Taiwan. Taiwanese workers benefited from greater opportunities to work than their rivals did during industrialization.

Finally, the working environments in factories matters. According to figure 3-11, Korea's annual rates of fatal injuries per 100,000 workers insured are consistently higher than in Taiwan. The average rates are 31 fatal injuries for Korea compared to 10.1 for Taiwan during the comparable years of 1988 - 2001.

VI. Conclusion

So far I have discussed on a sector-by-sector basis how and why Korea and Taiwan differed in terms of social bases for developmental coalitions. The chapter detailed how the political differences were reflected in the social bases of developmentalism in two rival economies, as well as how various sectors were accommodated along different developmental paths.

Korean industrialization heavily depended on *chaebols* who were private agents of political legitimization via economic performance. As the term 'corporate patriarchy' connotes, the owner controlled almost every important decision of his industrial empire. The developmental state consistently discriminated against SMEs in the name of "economy of scale" and subordinated them to chaebols, culminating in the SME Linkage Law of 1975.

In contrast, the Nationalists feared the rise of the big bourgeoisie and thus counterbalanced them by supporting SOEs' employees who were usually loyal to the KMT. Thus, big firms were discouraged on the island, although there were a few

[11] Theil index (http://utip.gov.utexas.edu/tutorials.html) was devised by Professor James Galbraith at

business groups that were loosely knit agglomerations of separate firms. SMEs were the economic agent of national wealth. They were given moderate, if not full, chances of financial access and investment incentives.

Banking sectors in both countries experienced nearly identical levels of financial development, although mobilization, distribution, and profitability of financial resources were totally different in the two industrial rivals. The Korean governments repressed the financial sector in order to mobilize cheap industrial funds to chaebols participating in the HCI project, culminating with the moratorium measure of 1972. Bankers were generally risk-takers in extending loans as the government usually intervened to turn bad loans into equity or reschedule repayment terms for debt-ridden big firms.

The KMT government employed a high real interest rate policy from the start, which was a rarity among developing countries in the 1950s. Bankers were successful in mobilizing savings to cover demands for domestic investments. Their loan extension was targeted at the broad goals of export industry in general, rather than at the financial needs of big firms. Bankers earned high returns on assets, but that was due mainly to the risk-aversion of state employees rather than to the the desire for profit among private entrepreneurs. Savers and financiers in Taiwan gained more benefits than those in Korea, where corporate debt crisis and bailout episodes recurred in 1969 – 70, 1972, 1979 – 80, 1986 – 88, and 1997 – 8.

The two developmental rivals were similar in constraining the autonomous popular sector, although they were different in providing material compensation in exchange for political demobilization. Farmers in Taiwan had a better chance of maintaining their businesses thanks to a moderate, if not complete, rural bias in the KMT government, smooth rural-to-urban economic transition, and the presence of SMEs in the rural community. On the contrary, agriculture in Korea was almost ignored during economic development, despite a temporary rural bias episode in 1970s. The government was concerned only with the urban industrial center which generated most of national wealth.

University of Texas at Austin to measure inequality of wage and household income.

Propinquity of the communist threat was the initial condition under which both small open economies employed labor-repressive regimes well before the EOI stage of the 1960s. But the Nationalists accommodated workers with more material benefits than Korean developmentalists. Taiwanese workers were given a relatively more material base of quietism compared to Korean rank-and-filers in terms of working hours, unemployment rates, wage differentials, and occupational injury.

In comparative perspective, the KMT government maintained and was supported by relatively broad and balanced social bases during its long political survival. This contrasts with Korean developmentalism, which funneled economic resources mainly to big business, resulting in narrow and skewed social bases. The next chapter will deal with how and why the different social bases of the developmental coalition were reflected in differences in central banker's autonomy and performance in the two industrial rivals.

Chapter 4: Different Central Banking Systems in Korea and Taiwan

This chapter discusses how and why the two central banking systems have experienced diverging historical paths up to today. In other words, this chapter examines my dependent variable – the different levels of CBI in Korea and Taiwan. I discuss the legal stipulations, the turnover of central bankers, their actual power within the government, as well as central bankers' performance (NPL and inflation).[12]

The first half of the chapter deals with the Korean case. The first section zeros in on the central bank's historical origin in the colonial period, and its development before the military coup of 1961. The second section discusses the "1962 financial system," where the military leadership relegated the central bankers to being a "rubber stamp" for developmental technocrats at the MOF. I measure the Korean CBI in terms of legal codes and turnover rates. The third section explores economic structures and sectoral preferences to see if CBI had a social base in Korea. The fourth section discusses financial regulations and supervision in terms of the MOF-BOK relationship and conflicts within the supervisory agency.

The latter half of the chapter details the Republic of China case. The fifth section focuses on the origins of the CBC on the mainland and its resumption on the island. The sixth section shows how legal stipulations and governorship turnover contributed to the independence of central bankers in Taipei. The seventh section discusses the amount of power central bankers actually enjoyed in Taiwanese officialdom. The next section shows that the central bankers had a pro-CBI socioeconomic arrangement and thus served as guardians of economic stability. The ninth section deals with financial supervision in a globalizing era and details CBC's strategic response to the financial market and the process of building an independent supervisory agency.

[12] I assume here that a higher CBI leads to better performance. A ceavat is that the CBI as institutional autonomy from political pressures does not always results in good policy results or capacity. In other words, autonomous central bankers sometimes lack effective policy tools or are simply incapable to realize what they intended to do.

I. The Bank of Korea: Its Historical Origins and Development Before 1962

Colonial Origin and American Proposals

Putting the feudal kingdom, *Chosun*, under their control, Japanese colonialists provided *Daiich Ginko*, a Japanese commercial bank, with the exclusive authority to issue banknotes, establishing the first unified currency system and assuming the function of a central bank for the Chosun government. In 1909 central banking functions were transferred to a newly established 'old' Bank of Korea, which was later renamed the Bank of Chosun (BOC) in 1911. The BOC continued to function as the central bank until Korean independence in 1945 (Cole and Park 1983: 44). During the colonial period (1919-1945), the central banking system in Korea was owned and controlled by the Japanese colonialists. Given that the BOC was also a colonial special bank and a foreign branch of the Bank of Japan, Japanese colonialists exploited the system to channel savings initially into Japanese industrial and commercial expansions and also into the Japanese war effort.

The BOC served as a pseudo-central bank in *Manchuria*, the northeastern region of China, funding military efforts and stabilizing inflationary pressures in the region. According to Baek Doo-jin (1975), a minister of finance in the 1950s, "moving closely with the Japanese army, the Bank of Chosun opened its branches and liaison offices in small cities to mobilize resources for the war effort. This is how Japan invaded mainland China economically and militarily." After Japan acquired Manchuria in 1931, it set up a frontier central bank, the Bank of *Manchukuo* (BOM), withdrawing the BOC back to Korea. Then the Japanese government financially supported its war efforts by establishing an inter-regional linkage – between the frontier BOM, the intermediary BOC, and the headquarters of the Bank of Japan. The BOC was a channel through which money went to the frontier in China and back to the imperial homeland in Japan.

The BOC almost became bankrupt at the end of World War II because it was cross-pressured by inflationary spirals from Manchuria and Japan. In addition, Japan exploited the BOC as its main provider of preferential policy loans for the homeland economy, which resulted in chronic non-performing loans: as early as the 1920s the ratio of non-performing loans amounted to 36.7 percent of its total credits (i.e., 119 million out of 325 million *won*) (Chung 1995: 225). The BOC almost lost its position as the central bank, and was relegated to a poorly-run commercial bank from the 1930s up to independence in 1945. Colonial conditions and the political exigencies of warfare weakened the BOC and subjected it to political pressures from the homeland and local governments.

After independence from Japanese colonial rule in 1945, the economic situation was chaotic due to the division of North and South Korea, the collapse of the Japanese-Korea economic linkage, and rampant inflation. While public discussion started under the Rhee government about establishing a new Korean central bank, the BOC, the Ministry of Finance (MOF), and *Cho-Heung* Bank competed with each other to take the lead in the process of "financial state building" (Chosunilbo Aug. 19, 2005). There was no consensus about who would be the institutional builder of the new central bank and which model it would be based on.

In the meantime the Korean and U.S. governments agreed to work together to rebuild the central banking system. In 1949 the MOF asked the Chairman of the Board of Governors of the U.S. Federal Reserve System to advise on reorganizing the new central bank, drafting new banking legislation, and formulating appropriate banking and monetary policies. The Economic Cooperation Administration (ECA) and the Federal Reserve Bank of New York sent two central bank officials, Arthur I. Bloomfield and John P. Jensen (1951: 3), to help build up the central banking system in the new born nation. The American drafters' sophisticated knowledge and skills surprised the Korean finance officials: Jang Ki-young, later a vice-prime minister, confessed his experience with them as follows:

> Dr. Bloomfield opened my eyes to the democratic financial system. Listening to and learning from him, I found that everything was new. He told us the American experience with Guatemala where the Federal Reserve had helped them establish their central bank, which fascinated us. I got determined with our new central bank. We learned from him the term, money supply. And we learned about central bankers' will to stabilize monetary value and thus inflation. (Han 1986: 85)

Bloomfield and Jensen proposed their final draft to the Rhee government, most of which was passed by the National Assembly in May 1950, a few weeks before the Korean War (1950-1953). The main recommendations of their policy proposal included:

> 1) transforming the Bank of Chosun into a strong, autonomous central bank, divested of its commercial banking activities, and concentrating primarily on the management of monetary policy and supervision of the commercial banks; 2) creation of a Monetary Board to set monetary policy and oversee the functioning of the monetary system; 3) strengthening the controls over the commercial banks and transferring them as rapidly as possible from government to private ownership; 4) implementation of forceful anti-inflationary policies, thereby achieving sufficient stability to create conditions favorable for financial growth and further institutional reform. (Bloomfield and Jensen 1951: 42-78)

In theory, the BOK was molded on the American Federal Reserve and thus had a variety of articles comparable to central banks in advanced countries. It had a specified and clear target of monetary stabilization; it was entitled to exert powerful and comprehensive authority covering the money supply, credit, foreign exchange, and bank supervision; it was politically independent from politicians and the MOF; it was not responsible to the government and the Assembly.

The MOF and technocrats criticized the new central banking system arguing "their [Bloomfield, Jenson, and the ECA's] draft proposed an absolute kingdom of the Monetary Board. The Board is expected to have more powerful authority than the president. The governor of the central bank will be *de facto* president while the current president will be *de jure* one" (Bank of Korea 2000: 22-23).

In practice, unfortunately, the BOK was not as powerful as the statutes stipulated. Shortly after the bill was passed, the Korean War (1950-53) broke out, and the most progressive elements of the Central Banking Act had to be abandoned or severely compromised in the interests of financing the war. With the end of the War, attention turned to the reconstruction of the war-devastated economy. The Rhee government established the Korea Development Bank (KDB) in 1954 to grant medium- and long-term loans to industries. The Bank's average share of total bank lending by all banks was 41.7

percent in 1955 – 1960. The KDB was placed directly under the authority of the MOF and was thereby independent of any control by the BOK.

In response, the Monetary Board opined against the government and the KDB. The Board argued that the KDB was illegal since it violated the General Banking Act that stipulated the BOK-led monetary and financial system. Furthermore, the Board rejected the KDB's request to print more money for purchasing the Industrial Bonds in 1954. On the other hand, as Bloomfield and Jensen had recommended before the War, the government privatized the commercial banking sector. The BOK welcomed the privatization package since it found it easier to regulate and supervise private banks than government-owned ones (Bank of Korea 2000: 399-400).

In general, the BOK's political independence and economic performance in the 1950s was not poor. The Monetary Board voiced its own policy alternatives to the government with external support from the American advisors and ECA that pressured pro-BOK stabilization packages in early 1957. The packages kept inflation within tolerable ranges: whole sale prices in Seoul increased 116.5 percent in 1952 but they nosedived to 6.3 percent in 1957-59.

II. The "1962 Financial System:" Subordination to Developmental Desires

Legal Changes and Frequent Turnover of Central Bankers

The Park government after the military coup of May 1961 chose industrialists as its developmental partner to compensate for its democratic deficiency. Industrialists and their peak organization, FKI, were quick to respond to the developmental requests from the government. The capital-hungry FKI offered its own policy proposals that were in turn accepted by the government in mid-1991. Those proposals were mainly for free inducements of foreign loans and "the central bank's support for their financing" (FKI 1991: 76). Furthermore, government-big business relations were direct, periodic, and intimate. In early 1962, Park set up the Monthly Conference for Export at his Blue House (i.e., the Korean presidential residence) to discuss what his coalition partners needed and what the state could do to help them. "The government promised a total support system to the FKI members" (FKI 1991: 84).

Then the Park government took control of the "financial nerve of industrial muscle." The culmination of the institutional changes came in May 1962, when the government revised BOK law so as to bring the central bank under the control of the MOF. The legal changes in the Central Banking Act were a "developmental manifesto" of the new government's policy orientation towards state-led industrialization. The principles of the BOK's autonomous power espoused by the American drafters were repudiated by the military leadership, who wanted to hold the nation-wide financial institutions in a tighter rein. There were several subsequent revisions during the 1960s and 70s, although they did not change the major format of the Central Banking Act of 1962 that I focus on here to show how it made the original Act fit into the developmental plans.[13]

First, the autonomy of the Monetary Board shrank. The military leadership increased the government-affiliated members from 3 out of 7 to 6 out of 9 on the Board (Article 8). Those members were the MOF minister (*ex officio* the board chairman) and 5 members recommended by three government ministers. In addition the MOF minister could request the Board to reconsider its policy decisions and, if rejected, the cabinet intervened to judge the final decision for policy coordination (Article 39, Section 1 and 2).

Second, the original Act stipulated that the president appoint the governor with 4 years in office guaranteed, while the grounds for the governor's dismissal were not clearly stipulated. The 1962 revision tipped the balance toward the government. The governor was put in office by the MOF minister's recommendation and then the cabinet's ratification (Article 23, Section 1). The president could oust, upon the minister's request, the governor even before the end of his term of office if he violated various banking rules (Article 114, Section 1). The government was legally authorized to dismiss governors who were disloyal to its developmental drives.

Third, the developmental leadership took hold of the BOK with a tight rein. The original law made it clear that it was the Board that ratified the annual budget plan of the BOK. But the 1962 revision removed the budgetary autonomy. The BOK should report

[13] See Bank of Korea. 2000. The Fifty Years of the Bank of Korea. Volume II. 222-323.

its budget plan to the cabinet which then could ratify or reject it (Article 7, Section 5). Furthermore, the MOF minister was authorized to supervise the BOK's monetary and financial affairs (Section 40). Thus the MOF was able to control the BOK's resources and policy decisions in its favor.

Fourth, from the perspective of two American architects, Bloomfield and Jensen, the central bankers were expected to take charge of foreign exchange affairs, especially in the poor and inflation-stricken country. Erasing Section 3 of Article 3, the revision authorized the MOF to take these affairs away from the BOK. The central bankers could not play the role of gatekeeper of financial transactions across the national borders while the MOF officials were capable of controlling massive amounts of American aid and foreign capital – both of which were lifelines for the war-devastated nation.

Fifth, the original law specified that the BOK could supervise banking institutions of any type within Korean territory. But putting the KDB, a major government-owned special bank, outside of the definition of "banking institutions" (Article 10, Section 1), the government gave *carte blanche* to the expansionist bankers without being supervised by the central bankers. In addition, the government involved the BOK fully in its developmental scheme by specifying that, if necessary, the BOK could purchase government bonds (Article 83, Section 2).

The 1962 revision brought what might be called the "1962 financial system," in the sense that the government held the central bankers on its tight leash to facilitate monetary and financial support for its developmental desires. The central bankers could not play the role of "the repository of reason against the short-term claim of passion" (Elster 1979: 89).

The 1962 financial system required central bankers to accept the developmental requests from the government whose social base was capital-hungry big industrialists. This structural relation suggests that one will see high turnover rates of central bank governors in Korea: government will oust "defiant" central bankers from their governorship for stubborn refusal to surrender to the governments' developmental pressures. Economic expansionists may expel "compliant" central bankers just because their performance is poor. Either way, the central bankers' lack of autonomy should result in high turnover rates for governors. Does Korea register a high turnover rate?

Table 4-1 lists the BOK governors since its inception in 1950. There were 22 governors in 55 years which shows the high turnover rate of central bankers: 0.4 governors a year and 2.5 years per governor. The shortest term of office was just three months held by Bae Ui-Hwan in 1960.

An interesting episode in 1963 reflects the status of the BOK vis-à-vis the developmental government. In 1963, the Park government made every effort to introduce foreign loans from France which in turn requested a certification for a possible default. Byung-Do Min, the seventh governor, was invited to the cabinet discussion. He refused to issue the certification due to the lack of foreign exchange reserves, which surprised and angered the cabinet members. Ten days later, the MOF sent a letter to the Monetary Board in order to legitimize its effort to put financial supervision under its jurisdiction. Min and the Board criticized the policy proposal in their reply letter. The government classified the letter to hide it from public attention. In response, Min chose to violate secret document regulations: he held a press conference to reveal the reply letter, making public the BOK-MOF conflicts over banking supervision. He resigned in protest after the conference (Han 1986: 461-6).

Central Bankers and Democratic Openings: A Historical Pattern

Historically speaking, the BOK's journey toward independence was characterized by a pattern of struggling for autonomy following democratic openings caused by governmental changes. After independence in 1945, the Bank of Chosun was criticized for its cooperation with Japanese colonial rule, and some bankers insisted on the democratic and autonomous operation of monetary and financial policies. This effort came to fruition when Bloomfield and Jensen drafted, in 1950, the first central bank charter, following the model of the American Federal Reserve system. Since then, the BOK's struggle for autonomy has been a "return to the 1950 charter spirit." Although the charter did not realize its own legal codes, in reality it taught the central bankers what an independent central bank should be.

When the authoritarian Rhee government (1948-60) was brought down by a democratic upsurge in 1960, some BOK staffers initiated the drive toward "political independence and neutrality," since senior officers of the BOK proved to be involved in money laundering for the ruling Liberal Party's election campaign (Bank of Korea 2000: 34). Thus, the BOK drafted a bill of their own and proposed it to the democratic Chang Myon government (1960-61), which later failed to pass because of the military coup of 1961.

In the 1962 financial system, the BOK remained a "*Namdaemun* branch" of the MOF (referring to the Seoul district where the bank was located), which demonstrated the BOK's subordination to the political will of the developmental government. After the *Yushin* regime fell in 1979 due to Park's assassination, there was a brief period of democratic opening, followed by the *Kwangju* Uprising in early 1980. The BOK's journey toward autonomy restarted. Chun Sung Kim, the thirteenth governor, obtained a promise from the MOF to allow the self-determination of operational budgeting, which was reflected in the fifth revision of the charter, but other things remained status quo (Bank of Korea 2000: 46-7).

How did the democratization in the mid-1980s affect BOK's status vis-à-vis developmental government? The "June Uprising" in 1987 forced the authoritarian Chun government to grudgingly accept a democratic transition, which prompted the BOK to take action. Officials at the *Pusan* BOK branch publicly pronounced their hope for the BOK's political autonomy, which was followed by supportive announcements from every branch as well as the headquarters. Since the presidential and general elections were scheduled for late 1987 and early 1988, respectively, each political camp promised to support the BOK's autonomy in order to win those "founding elections," which would determine post-transition politics.

The course of a great debate between new democratic government and opposition parties was concerned with two issues: the central bankers' independence and bank supervision. In July 1988 three opposition parties drafted a joint proposal for a new BOK charter which started a great debate in the political realm. The proposal was in favor of the BOK, suggesting that the Monetary Board chairmanship should be held by the governor rather than the finance minister, and the supervision of non-bank financial institutions and foreign exchange affairs should be put back under the central bankers' jurisdiction. On the other hand, to appease possible resistance from the government, the opposition parties allowed the finance minister some legal authority over the Board's important decisions (Bank of Korea 2000: 49).

As a preemptive measure, the Roh government (1988-1993) and the governing Democratic Justice Party announced their version of central bank charter in December 1988. Grudgingly accepting that the governor should assume the Board chairmanship, they proposed a plan where the bank supervision authority would be taken away from the BOK and given to the Financial Supervisory Service under the control of the MOF (BOK 2000: 49). This proposal was a typical *divide-et-impera* strategy since the government was trying to divide the BOK into two agencies – the BOK, as the monetary agency, and the Service, as a separate financial regulation/supervision agency.

In response, the 17th governor, Kim Kun, rejected both of the proposals from the opposition and the government. His plan was to "return to Bloomfield-Jensen's origin." He supported the original charter which stipulated the BOK's complete independence and comprehensive jurisdiction including monetary, financial, foreign exchange, and supervision affairs. The governor chose to launch a "petition signature drive" which succeeded in mobilizing 1 million signatures from citizens in the streets in only two months (BOK 2000: 51).

The standoff between the bargaining players continued till 1989. In the summer of 1989, the MOF proposed its own bill to the government-party joint committee which then passed to the Assembly. The opposition parties also submitted their version to the floor. But the Assembly could not reach a compromise so the great debates fizzled in late 1989 (BOK 2000: 53).

The 1990s saw the persistence of the 1962 financial system. The story of Cho Sun, the 18th governor, demonstrates the persistence. In late 1992, Chung Ju-Young, an opposition presidential candidate, stated in public during his campaign that Governor Cho had arbitrarily ordered the printing of money worth 300 billion *won* to contribute to Kim Young Sam, the candidate of the ruling party. In response, Cho appealed to the court accusing candidate Chung of misrepresentation in public. After Kim won the presidential election, the governor withdrew his lawsuit. President Kim put him out of office upon his taking the presidency, saying that Cho himself resigned for personal reasons. But the fact is that his resignation was due to his "rudeness:" he withdrew the legal case without consulting the president-elect in advance (Bank of Korea Labor Union 2002: 27). He served just one year, March 1992 to March 1993.

In the first year of Kim Young Sam's government (1993-1998), support was voiced for the BOK's autonomy in learned circles. In May 1994, forty-one economics scholars pronounced at a news conference the urgency of the central banker's independence, which triggered a policy debate among the ruling party, the opposition parties, and civil organizations. But the debate repeated the process of 1987-89 and fizzled out without any policy compromise among them (BOK 2000: 54-55).

The debate resurged in early 1997 when President Kim made public the exigency of financial reform at a presidential news conference. The government formed Financial Reform Committee introducing a public forum to discuss the almost 50-year-long issue of central bank independence. In June there was a "four-man pact" among the presidential economic secretary and the heads of the MOFE (Ministry of Finance and Economy), the BOK, and the Committee. Unfortunately, the pact heavily reflected the old MOF proposal of the past. Many BOK officials mobilized fierce street protests blaming their boss, Lee Kyung-Sik, for his behind-the-scenes collusion with the developmental technocrats. The turmoil continued until the Asian financial crisis hit Korea hard in late 1997. The situational urgency made the Assembly pass in December 1997 a bill of compromise between the government and the opposition parties (BOK 2000: 62-82).

The compromise improved the central bankers' autonomy at the expense of their authority to supervise. The BOK made some gains: the government-recommended members decreased from five to two out of seven Monetary Board members; the governor took the Board chairmanship; the Board membership was legally guaranteed for four years; the finance minister lost his authority to ratify the BOK operation rules (BOK 2000: 83).

On the other hand, the central bankers lost in terms of financial supervision: the MOF divested bank supervisory authority from the BOK, establishing the Financial Supervisory Service (KFSS) which covered the whole gamut of the banking industry, stock market, and insurance companies (BOK 2000: 84). It should be noted that the FSS is not an independent agency: it is under the jurisdiction of the Financial Supervisory Commission (KFSC) which is heavily subject to the government's and MOF's pressures.

In sum, BOK officials have always been active during political openings caused by government changes in hopes of achieving autonomy from government pressures, but have always failed to do so. Why is it that even political democratization in mid-1980s was not able to break through the 1962 financial system? Why is the old system persistent? This suggests that there is a socioeconomic structure which determines whether CBI in a country is sustainable or not. The next section deals with the social arrangement of group preferences toward monetary and financial stability.

III. BOK: Captured by Big Industrialists and Guarding Bank Loan Capitalism

How did the social bases of developmetalism in Korea affect central bank independence? As indicated by table 3-3, the main industrial bases of the top 10 largest companies were electronics, petroleum, chemicals, motor vehicles and transportation equipment. Table 3-1 shows that the top 5 companies produced 45 percent of the GDP in the manufacturing sector. These data suggest that capital-intensive industries have been the backbone of big industrialists.

Since it is hard to move assets of heavy and chemical industry to another use due to a high ratio of fixed capital investment and long duration of profit gestation, big industrialists are closely wedded to their current activities and have great incentives to obtain government policies that favor their business operations. Furthermore, since the developmental government decides which firms will invest how much to which sector when technocrats draft an economic plan, the capital-intensive asset holders have great incentives to lobby for government policy because their assets' rate of return depends on public policy (Frieden 1991: 20-1).

On the other hand, industrialists in Korea consist of a small number of big businesses. Geographically they are concentrated in a few industrial regions (Seoul-Kyungin area and Youngnam area in the southeast) which contributed to the great internal cohesion of the capital-intensive industry sector. The political influence that the capital-intensive sector has brought to bear on the government has been great:

developmental governments have been accepting almost 90 percent of FKI's policy recommendations (Shafer 1990: 137).

The government – big industrialist relationship suggests that central bankers will have a problem in controlling monetary supplies because of inflation. Since it is theoretically obvious that high inflation favors debtors vis-à-vis creditors, inflation is tolerable and even favorable to debtor industrialists. Figure 4-1 shows cross-national variation in inflation rates from 1960-1990. It is clear that the big industrialist-driven Korean economy was subject to a higher inflation rate than its industrial rival: the three decades' average inflation rate is 15.6 % for Korea and 5.7 % for Taiwan. Korea experienced inflation almost three times higher than Taiwan did.

Given that Korea experienced a relatively similar level of financial development measured by the ratio of total financial assets to the GNP as indicated by Figure 3-1 in the previous chapter, why did the financial sector in Korea not bring its sectoral preferences for price stability, and thus central bank independence, to bear on the government as much as their counterparts in Taiwan? In the 1960s and 1970s, when commercial banks dominated the financial market, the developmental government always intervened by choosing heads of commercial banks among top banking officials to put financial institutions under the politicians' expansionist control. Since the 1980s when NBFIs ruled the financial market over commercial banks, a few groups of industrialists and chaebols often owned the NBFIs, replacing the state as the largest shareholders. This is why the financial sectors could not voice their own sectoral preferences toward price stability. A dependent financial sector results in a dependent central bank.

SMEs and agricultural sectors may counterbalance big industrialists' expansionist desires. If the political leadership cares about subordinate groups (mainly about canvassing votes from those sectors), the government will not overinvest its material resources in capital-intensive sector. Unfortunately, SMEs and farmers were excluded from the narrow developmental coalition, which prevented them from organizing and having their interests represented. There have been no serious distributive conflicts in which the developmental government felt it necessary to support subordinate groups, thereby compromising big business-oriented economic strategy. What do the central bankers do when they are forced to be obedient to a government "captured" by big bourgeoisies?

The other problem related to monetary supply that central bankers faced was preferential credit extension. "In a repressed financial system, a government maintains artificially low interest rates. Because this induces an excess demand for credit, the government is drawn into the process of rationing financial resources among competing uses, i.e., preferential credit schemes"(McKinnon 1973). Therefore, if central bankers do not wield authority independent from the government, they will do a poor job when it comes to regulating preferential loans that increase financial risks in the financial sector. Central bankers' independent authority can be proxied by non-performing loans (NPL) of commercial banks as a percentage of the total credit, which Figure 4-2 graphically shows.[14]

It was mainly "long-term" foreign loans that the Park government borrowed from Japan and the U.S., which resulted in the low NPL ratio in the 1960s. But this did not last long. As foreign loan repayments began a decade later, the NPL ratio rose rapidly in 1969. In response, the Park government launched stabilization packages right after the 1969 presidential and general elections. Serious and chronic NPL problems in the 1980s, and the early and late 1990s were due to the extremely weak financial structure of private businesses. The debt-to-equity ratio of private firms in Korea was 250-320 percent during 1976 to 1990, whereas the ratio in Taiwan was 100-120 percent in the same period (Lee 1999: 409). Central bankers were not able to prevent private bankers from extending credit to debt-ridden firms since they were under the tight control of the technocrat-filled EPB and MOF which were eager to funnel capital, domestic and foreign, to the industrial sector. The BOK simply could not perform what it was supposed to do.

The Taiwan case shows that there, the NPL ratio has been relatively well controlled. The Central Bank of China (CBC) enjoyed full delegation of supervisory authority from the MOF and KMT government. Covering all the financial intermediaries in their responsibility, they were "harsh" in monitoring and punishing any inappropriate credit extension. The central bankers' authoritative regulation and supervision

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[14] Unfortunately pre-1981 data for Taiwan are not available.

contributed to a sound financial balance and immunity to external shock, especially in the 1997 Asian financial crisis.

Dependent central bankers in Korea were not only incapable of supervising the NPL of commercial banks, they were also active in extending preferential credits to debt-ridden big firms. The *Haneun Tukyung* (BOK Special Credits) is a typical example of the central bankers' financial intervention in the market. This means that the BOK granted a low-interest, long-term "special credit" to financially troubled banks and firms. The BOK simply printed more money to prepare the special funds. In 1972 when the Park government launched the heavy-chemical industrialization, it increased the foreign exchange rate by 18 percent to encourage the export industry. But the measure led to financial troubles (i.e., debt service) for debt-ridden big firms that had depended on borrowed foreign capital. So the government forced the central bankers to extend special low-interest loans to troubled firms and banks (Bank of Korea 2000: 445-50). The mechanism of the special credit was as follows: The government allowed debt-ridden banks to issue 200-billion-*won* bonds which the BOK in turn purchased at a 5.5 % interest rate compared to the 20 % interest rate in the money market. In this way, the relieved banks rescheduled the firms' debt service, spreading costs over a long period. Thus, the money went from the BOK to high-leveraged firms through the bond-issuing private banks (Chung 1995: 272-4).

The central bankers extended other special loans in the middle of the industrial restructuring of 1985. In July, the BOK faced pressures from the Chun government which was then struggling to streamline its inefficient industrial structure. The BOK revised its own charter, under the MOF's tacit approval, to manipulate the legal foundation for the "Industrial Restructuring Fund." In three times, it extended 1.72 trillion *won* to six commercial banks at the low interest rate of 3%. The central bankers volunteered to shoulder the loss incurred by their constituent commercial banks which were trapped by debt-ridden big firms (Chung 1995: 274).

In a way, the Korean central bankers were "successful" in employing preemptive measures to alleviate possible banking crises. The BOK's preferential credit extension, however, alleviated policy loan-led banking crises through printing more money. In other words, it was "government intervention" for "government failure." Its mechanisms progressed as follows: expansionist policy loans led to debt-ridden firms which caused an insolvent debt and an insolvent banking operation which led to a looming financial crisis and a special credit by the central bankers.

The BOK's credit policy violated Bagehot's principles (1878) about the lender of the last resort. First, by stipulating that the central bankers lend freely at a high interest rate, Bagehot emphasized the penalty imposed onto private bankers' insolvency. The BOK's credit was a very preferential benefit, considering the low long-term interest rate of 3 % in the inflation-stricken Korean economy. Second, by stipulating that the central banks protect not individual institutions but the market in general, Bagehot called attention to the central bankers' neutrality and fairness. In Korea, the beneficiaries of the credit were specific firms and banks highly leveraged due to the risky and inefficient management of their assets.

In sum, the central bankers in Korea may have been successful since they effectively prevented banking insolvency in the 1970s and the 1980s through preemptive credit extension. In doing so, though, they contributed to a moral hazard on the part of private bankers and entrepreneurs since they lost an opportunity to learn to prudentially use the financial resources in their hands.

IV. BOK: Poor Regulation in Financial Liberalization

In theory, the role of the lender of the last resort leads to a "moral hazard" on the part of market agents because they tend more often to be risk-takers than they would be without a central bank of the last resort. This suggests that the role of the "lender of the last resort" cannot function without proper financial regulations and supervision.

According to the original Central Banking Act drafted by Bloomfield and Jensen, the BOK was powerful in financial regulation and supervision; the Department of Bank Supervision at BOK was expected to regulate most of all the financial institutions' operations. Under the 1962 system, the MOF regulated and supervised special banks and non-bank financial institutions (NBFIs). How many financial resources did the BOK regulate and supervise in the developmental era? Table 4.2 shows the composition of financial intermediaries in terms of loans and investments of the total credit in Korea.

Given that the BOK regulated commercial banks, it took charge of 42.80 percent of the total credit in the 1970s, 37.75 in the 1980s, and 20.55 in the 1990s. The central bankers' coverage of financial supervision was quite limited compared to the MOF which covered all the rest of the financial institutions. Financial bureaucrats controlled 57.2 percent of the total credit in the 1970s, 62.25 in the 1980s, and 79.45 in the 1990s.

Interestingly enough, specialized and development banks that used to be the main financial channel of capital-intensive industry in the 1970s-1980s lost their financial ground as the economy liberalized, especially in the 1990s. Their shares decreased from 49.27 percent of the total credit in the 1970s to 17.46 in the 1990s. Instead the chaebol-dominated NBFIs such as merchant banks, investment companies, mutual credits, trust accounts of banks, insurance, and securities grew rapidly, with their shares increasing from 7.93 percent of the total credit in the 1970s, to 23.68 percent in the 1980s, and to 62 percent in the 1990s. NBFIs gained profits by channeling short capital, foreign and domestic, to the capital-hungry industrial sector.

The Korean case shows that financial deepening and liberalization have differential impacts on the state agencies. The central bankers lost while the MOF gained. In addition, financial liberalization does not always force the government to shed its power over the market. The state does not simply deregulate. The MOF bureaucrats could re-arrange their control over the market by putting the increasing number of NBFIs under their jurisdiction.

How does the "division of labor" in financial regulation shed light on Korea? The division of labor led Korea to the crisis. The Ministry of Finance and Economy (MOFE)[15] governed most financial resources, foreign and domestic, although it lacked onsite regulatory and supervisory skills and techniques; it specialized in financial "policy-making." Thus the MOFE could not update supervision-related laws to fit the financial globalization era. It sometimes delegated its examination authority to the Bank Supervision Service at the BOK on a case-by-case basis. But the temporary delegation did not include law enforcement power for the BOK examiners. The partial and

[15] Ministry of Finance and Economic Planning Board was integrated into Ministry of Finance and Economy in 1994. After the Asian crisis, the MOFE delegated its economic authority to other ministries in 1998.

intermittent delegation of supervisory authority connotes inconsistency of "authority and responsibility" or "examination and discipline." An official at the BOK confessed, "Frankly speaking, we were not that hard-working with onsite examination because, even if we reported inappropriate operation cases to finance officials, they often took no action with the troubled banks" (interview, summer of 2003, Seoul Korea).

The MOFE was active increasing number of its policy constituents under its jurisdiction: they approved a lot of merchant banks in the name of financial liberalization. There were only six merchant banks in the early 1990s, but thirty merchant banks operated in 1997. In addition, to the MOFE's indiscreet issuing of licenses, the urgent financial needs of debt-ridden big industrial firms contributed to the rapid increase of the NBFIs. Those firms resorted to NBFIs which were subject to less strict regulations under the MOFE, compared to banks regulated by the BOK (Choi 2002: 105). Inexperienced branches of Korean merchant and investment companies were concentrated in the Southeast Asian region, especially Hong Kong, where the financial sector usually dealt with short-term capital and did not require strict eligibility for business operation compared to the U.S. and European markets (Choi 2001: 49). When the Asian crisis occurred, the impact transmitted along financial nerves back to Korea.

It should be noted that a behind-the-scenes reason for the MOFE's inability to maintain prudential operation in NBFIs was the traditional convention by which ex-officials who retired from the Ministry often took office at the NBFIs. The Ministry had a "good relationship" with the merchant banks that later triggered the 1997 crisis in Korea. The chairman and vice chairmen of the Merchant Banks Association of Korea at the time of the Asian crisis came from the Ministry. Their presence made it difficult for MOFE officials to supervise and discipline the NBFIs, since MOFE officials are notorious for their *esprit de corps*. Koreans used to call them *mofia*, referring to the mafia. The convention resembles the Japanese MOF-*jusen* (companies that specialized in extending collateral loans for housing facilities) in the sense that senior officials at the *jusen* consisted of retired Japanese MOF ex-officials. Thus the lack of prudential supervision of the *jusen* contributed to the nation-wide bubble economy and finally the banking crisis in the early 1990s (Choi 2001: 41).

A labor unionist (interview, summer of 2003, Seoul Korea) at the BOK commented on political and institutional status of MOFE:

> The MOFE is a kind of developmental dinosaur as they have tremendous power over the Korean economy. We cannot challenge them…. They have a lot of official and unofficial dense institutional connections with *chaebols*, bankers, and the non-banking sector. The personnel network clearly demonstrates that. Nearing retirement, senior officials are eager to find positions available to them, especially advisor positions at a private big company, investment companies, and state-owned corporation…. When we see the government try to set up a new economic institution, we joke "Oh, there should be a lot of retirees at the MOFE." Facing the powerful MOFE, frankly speaking, we BOK staff have a kind of defeatism vis-à-vis the Ministry.

The inconsistent regulation and supervision led to a lack of financial prudence in the Korean financial sector. As Figure 4-2 in the previous section shows, the NPL ratio clearly demonstrates the trouble. The developmental finance regime was quick to liberalize the financial sector in the early 1980s but slow to prepare protective measures for savers, corporate and individual. The Korea Deposit Insurance Corporation (KDIC) started its operation on the first day of 1997, the year of the Asian crisis. In contrast, Taiwan established the Central Deposit Insurance Corporation (CDIC) in 1985, 12 years before Korea.

In fact there is no agreement among economics scholars whether a financial supervisory institution independent from central banks contributes to financial prudence in the globalization era (Kim 2002: 12-6). As Barth, Caprio, and Levine argued, although financial supervisory practices lead to accurate information disclosure and limit the moral hazard incentives, it is not clear whether measures of supervisory independence are linked with better banking performance or stability (Barth, Caprio, and Levine 2002: 39). This suggests that the institutional arrangement may often be determined by historical and political conjunctures. The MOFE accomplished its long-time wish for an integrated supervisory institution by depriving the BOK of its supervisory function and establishing the Korean Financial Supervisory Service (KFSS) after the Asian crisis.

Does the KFSS enjoy autonomy within its operation? Unfortunately, the government still controls the KFSS by putting the private organizations under the jurisdiction of the Korean Financial Supervisory Commission (KFSC), an arm of the government. The KFSS follows directions determined by the KFSC. A top labor unionist (interview, summer of 2003, Seoul Korea) at KFSS commented on their unfriendly relationship with the KFSC:

> The Monetary Board and the BOK are an integrated single unit, but the KFSC and KFSS are different organizations. They are state officials; we are not. We are private. The KFSC has its own executive office for policy planning and implementation. So they often tell us, "follow our lead." It is very suspicious if they can really regulate the financial industry fairly and neutrally. There are many cases that prove our suspicions. As you know, most of the senior KFSC policy-makers came from the MOFE. When we argue for fair and clear supervisory operations, they often ignore our appeals. This is why we fight them. If not, they won't let us share supervisory authority with them.

The high turnover rate of the KFSS chairmanship reflects its lack of autonomy vis-à-vis the KFSC and the government. Table 4-3 lists the chairmen since 1998. There were five chairmen since its initiation in 1998. The turnover rate, measured by the number of chairmen per year, is 0.71 chairmen per year. Each chairman served, on average, for 18 months. Most of them used to be senior officials at the MOF/MOFE, which suggests that the KFSS is dependent on the MOFE in terms of its personal network.

Given that central bankers take charge of the supply of money and credit as well as the role of "lender of the last resort," they need accurate information about the domestic financial sector. Do KFSC and KFSS provide the information to central bankers and cooperate with each other for better regulatory performance? A mid-level official (interview, summer of 2003, Seoul Korea) at the KFSS confessed, "Not really:"

> We [the KFSS] are not in a good relationship with the BOK and MOFE. Our unfriendliness is echoed in the activities in international organizations….They [the BOK] joined the EMEAP (Executives' Meeting of East Asia and Pacific Central Banks), established in 1991, while the

> MOFE attended an inter-governmental organization, the ACC (BIS Asian Consultative Council), even though those organizations shared a lot of operations. When the BOK joined it, they deliberately alienated the KFSS. We don't share discussion materials and data with BOK officials….. As you say we may have to cooperate with BOK to counterbalance the power that MOF(E)-KFSC group has…. But we don't cooperate with central bank officials since they [BOK] opposed setting up of our institution [KFSS] and we still remember the bad feeling that we had a few years ago [1998]…..I would say that we are subject to so-called organizational egoism.

In sum, the central bankers did not enjoy independent authority under the 1962 financial system that still lingers over the Korean financial sector – even after democratization in mid-1980s. Captured by the interests of capital-hungry big industrialists, government politicians and bureaucrats did not allow central bankers autonomy to do what they are supposed to do. The BOK's independence is very poor in terms of legal codes, governors' turnover, central bankers' status within the state, and performance (i.e., inflation and NPL).

V. The Central Bank of China: Its Historical Origins and Development

The CBC on Mainland China

The year 1906 witnessed the birth of the first government bank, the *Hu-Pu* (Board of Revenue) Bank which was reconstituted as the Bank of China in 1912. The charter granted it the right of note issue and made it the government fiscal agency. But at the same time the government granted a similar charter to anther government bank, the Bank of Communications on the recommendation of the Board of Posts and Communications (Chang 1958: 174). The government did not regard the central bank as the single commanding height of the financial system distributing central banking privileges to those two aforementioned government banks. The government simply hesitated to determine "who will be the central bank?"

Assuming office in Canton as the Supreme Commander of the Army and Navy in 1923, Dr. Sun Yat-sen, "the Father of Modern China," and his government suffered from lack of public finance because taxes levied were completely under the control of local warlords. In 1924 the Sun government resolved to launch Central Bank of China (CBC) in Canton (Central Bank of China 1996).

The historical origin of the CBC was the government's financial need to fund the budget deficit and support the war efforts against local landlords, communists, and later the Japanese empire under the condition that domestic commercial banks were merely money shops. The Bank was Dr. Sun's "financial state-building project." The CBC shares with European central banks the historical origin: the government's financial need for resource mobilization. Early commercial bankers in Western Europe usually started their central banking business by getting temporary licensing charters in exchange for funding governments' debts from war efforts during the seventeenth and eighteenth centuries (Chung 1995: 74). As Kindleberger (1984: 7) argues, "War is a hothouse and places enormous strain on resources, which finance is used to mobilize. Financial innovation occurs in wartime."

Unfortunately, Dr.Sun's efforts for a central banking system failed to establish its status as the leading center of the financial community in mainland China because the CBC did not command a monetary monopoly, nor was it a leader in the banking community. First, the government could not provide the CBC with the charter to monopolize the right to issue notes. With the creation of the CBC, the Bank of China and the Bank of Communications were willing to forego their right of note issue and to withdraw their notes from circulation as soon as the government had repaid the outstanding balance of their advances, amounting to CNC $100 million. The government, however, was not able to liquidate its debts with the two banks and thus two banks continued to issue their own notes as before (Chang 1958: 176).

Second, the CBC was not the center of the financial industry. It still struggled for recognition in a banking community dominated by the old and well-established Bank of China and the Bank of Communications. Furthermore, the CBC could not significantly influence the supply of credit by manipulating the rediscount rate since the volume of transactions in the discount market was small. It was unable to conduct open market operations in bonds. Basically, the CBC was a local bank limited to Canton without significant financial policy tools it could exploit.

In 1927 some finance officials in the Chiang Kai-shek government tried again to establish a central banking system, creating the Statute of the Central Bank of China. This measure announced that the CBC was the national bank and had a number of special privileges conferred upon it by the Nationalist government. The Chiang government accepted policy recommendations drafted by Sir Frederick Lieth Ross for far-reaching monetary reforms. Following American and English central banking systems, the draft advised that the CBC take responsible for note issue, rediscount, control of money markets and the credit supply. Unfortunately, the plan aimed to ensure independence for the CBC but failed to be ratified and was dropped (Chang 1958: 175).

The CBC under the Chiang government was not able to perform as an independent central bank at the national level. The board of the CBC was dominated by government nominees, and sound financial and monetary principles could not be maintained against the considerations of political expediency (civil war and the Sino-Japanese War). Moreover, the Chinese banking industry was concentrated in Shanghai money markets. Although the modern banks wanted to extend their businesses into the interior where they could operate without competition from the foreign banks, they feared that local governments and warlords would levy heavy "political taxes" onto their financial businesses. Even in Shanghai the banks were not entirely free from central government interference (Chang 1958: 179-181).

As a result, the CBC was unable to control macroeconomic stability within tolerable limits. Tables 4-4 and 4-5 show the CBC's failure to stabilize monetary value and the government's deficit due to war efforts. Inflation spirals were disastrous. The price skyrocketed from 100 in 1937 to 163,160 in 1945 in the Free China area. Furthermore, government finance ran into huge budget deficits. Between 1937 and 1948 the expenditures increased from 1,992 CNC million dollars to 655,471,087 while the revenue did not catch up with the expenditure increases, which caused a serious crisis in public financing. The deficit increased from 560 CNC million dollars to 434,565,612. It was an increase of 776,010 times.

The CBC on the Island: Delegation and Resumption

Following the Chiang government, the CBC moved to Canton, Chungking, Chengtu, and finally to Formosa (i.e., the old name of Taiwan) in December 1949. The government delegated all functions of the CBC, except for fiscal-agency, to the Bank of Taiwan (Central Bank of China 1996: xxi). The delegation was due to the fact that the CBC was not familiar with the financial situation on the alien island and needed time to prepare for its own operations. Another reason was that the Nationalist leadership in the 1950s did not give up on the unification of China by military rollback. They did not want the CBC to take root in the small island, since that would mean a consolidation of divided state-building in the eyes of the KMT leadership. Instead, the Bank of Taiwan performed the 'local' central banking business.

In order to speed up economic development, the KMT government announced in 1959 its "19-Point Program for Speeding Up the Process of Economic Development" which stipulated that a central banking system should be established. In 1961 the CBC started its operations in Taipei. The 1961 resumption took place when the Nationalist leadership gave up on the idea of military rollback for national unification and instead regarded economic growth as another form of competition vis-à-vis the communist regime on the Mainland.

In comparison, the CBC's experience resembled the historical experience of the Deutsche Bundesbank. The Reichsbank, established in 1875 according to the advanced English model, did not dominate the financial community and thus grudgingly allowed 32 local commercial banks to issue their own notes. During World War I, the central bankers cooperated with the German government by printing paper money and wartime bonds and extending huge loans to the government for war efforts, which led to the depreciation of paper money and hyperinflation. After taking office in 1933, Hitler and the Nazi government held the central bankers on a tight leash and thus the German central bank cooperated with their rulers for the war effort during World War II. As the Deutsche Bundesbank, now the world's most autonomous and powerful central bank, was created only after the historical experience of war, the KMT government established the independent CBC on the island after experiencing hyperinflation in the mainland.

VI. The CBC's Legal Status and Turnover of the Governorship

Legal Stipulations: The Central Bank of China Act

Has the CBC enjoyed independence from the KMT government since 1961 when it resumed operation? Let me first discuss the legal aspects of the 1979 Act of the Central Bank of China to examine the level of CBC independence.

In general, an independent central bank tends to have the narrow and explicit macroeconomic aim of the external and internal stabilization of monetary value, which is meant to strengthen policy credibility in the eyes of financiers and savers, domestic and foreign. If a central bank has multiple aims in its charter, there may be policy conflicts among them. For instance, when high inflation occurs, central bankers may have the excuse that the monetary instability was due to another aim that the central bank has to respect such as promotion of economic growth (Chung 1995: 212).

The CBC had multiple aims in its charter, including promoting financial stability, guiding a sound banking system, maintaining the stability of the internal and external value of currency, and fostering economic developments. So there arose possibility of conflict among the policy objectives. A political economist (interview, summer of 2003, Taipei Taiwan) commented about it:

> You might say there could be inconsistency in the CBC's goals in the charter, say, between monetary stabilization and contribution for economic development…. I would say from my experience that such policy conflicts occurred rarely in the past. That's because there has been a consensus of macroeconomic stability among the members of the Board of Directors…. In my opinion, the multiple aims, rather, reflect the fact that the central bankers have the power to control monetary policy as well as other relevant economic affairs.

In addition to multiple policy aims, the CBC charter was loose. It has only 44 articles, compared to the 119 articles in the Bank of Korea charter. The original American drafters of the latter thought that detailed specifications would clarify operations, thus reducing possibilities for policy failures. Thus the BOK charter included articles that were absent in the CBC charter. Among those were articles and sections about how to dismiss members of the Monetary Board, who could not be a Board member, how to take responsibility for the loss incurred to the BOK due to the Board members' policy failure, etc.

In contrast, the KMT government delegated to the CBC a considerable range of monetary and financial policies, not detailing what it was expected to do or not to do. A mid-level CBC official (interview, summer of 2003, Taipei Taiwan) claimed "the loose and short legal codes connote room to maneuver that we [the CBC] can exploit and enjoy."

According to Article 5, the Board of Directors consisted of eleven to fifteen directors to be nominated by Executive Yuan (i.e., cabinet) and appointed by the president. The standing Executive Board of Directors, the power center of the CBC, included seven directors from among the members of the Board. Those seven directors were the governor, the ministers of Finance and Economic Affairs, and one representative each from the agricultural, industrial, commercial, and banking sectors. In comparison, the composition of the directors suggests less governmental influence in Taiwan than in Korea. According to the CBC charter, two out of seven Board members came from the government while in Korea six out of nine Board members were government officials or government-recommended members. In addition, the CBC governor's term of office was five years and he might be reappointed upon the expiration of the term (Article 10). He was the chairman of the Board of (Executive) Directors (Article 23) in contrast to the BOK where the MOF minister was the chairman of the board.

Which policy area did the CBC Board of Directors cover? Article 6 specified its powers and functions as follows:

> to examine policies concerning money, credit, and foreign exchange; to examine the adjustment of the Bank's capital; to approve the operation plans of the Bank; to examine the budget and fiscal reports of the Bank; to examine and approve major by-laws and regulations of the Bank; to examine the establishment and abolition of the Bank's branch offices; to approve the appointment and the removal of the Banks' department heads and their deputies, and branch managers; to examine matters proposed by the Governor. (Central Bank of China 1996: 260-1)

Legally speaking, the Board enjoyed more autonomous authority than its Korean counterpart BOK did. Before the 6th revision in 1997, the MOF in Korea decided whether it would approve the fiscal statements and budget plans that the BOK reported. The Monetary Board could not approve major regulations of the BOK. Instead the Board members had to explain to the MOF why they wanted to change the operation rules, then wait for a bureaucratic okay. The MOF's monopoly over making and revising the BOK-related laws was the legal tool that developmental bureaucrats had over the central bankers.

Article 38 of the CBC charter was about the central bankers' financial jurisdiction. "In conformity with the powers and functions authorized in this Act, the Bank shall undertake the examination of the operations of all financial institutions in the country. The above examination may be performed in coordination with the bank examination program delegated to the Bank by the Ministry of Finance" (Central Bank of China 1996: 269). In contrast, the BOK covered only commercial banks with the exception of specialized banks and development banks that are under the control of the MOF.

Taiwan, as a small open economy, emphasized the external value of money, i.e., foreign exchange. The CBC charter clarified in Articles 33 and 35 that central bankers should hold international monetary reserves and undertake the overall management of foreign exchanges including authority to appoint and supervise banks engaging in foreign exchange operation, to examine and approve private outward and inward remittances, and to supervise private enterprises' foreign borrowing guaranteed by approved banks (Central Bank of China 1996: 268-9).

The CBC took full responsibility for foreign exchange transactions, which was not within the jurisdiction of the BOK. Although the American designers made the transaction the main coverage of the BOK, the 1962 revision authorized the MOF to take these affairs away from the central bankers.

In a nutshell, the central bankers in Taiwan are more autonomous and independent in a legal sense than their Korean rivals. In reality, though, legal codes might not always match the actual practices. Have the central bankers in Taiwan actually enjoyed as much autonomy and power as the charter specified? The next section deals with turnover rates of CBC governors comparing ones of BOK.

Low Turnover Rates of the Central Bankers

The turnover rates of the central bank governors represent levels of the CBI in the sense that it is easy for government officials to change governors if central banks do not enjoy independent authority. Tables 4-6, 4-7, and 4-8 list the CBC governors in Taiwan since its inception in Canton. The CBC governors before the Nationalists' relocation to the island enjoyed their terms of office for 2.6 years on average. The turnover rate measured by number of governors per year was 0.38, comparable to the Korean rate, 0.4. That period registered the CBC's poor performance, as proved by the disastrous hyperinflation and its subjection to the Nationalist government's war efforts.

After the KMT's defeat and withdrawal to the island, the government started to put a high priority on macroeconomic stability. The turnover rates decreased significantly, compared to the Mainland period. The CBC had 3 governors in 12 years, so governors enjoyed, on average, 4-year terms of office. The turnover rate was 0.25 which suggests that CBI is higher after relocation than in the mainland. The turnover rate will be even lower if one omits Fei-perng Yu, since he was actually a two-month-long deputy governor who acted temporarily on behalf of the governor.

The CBC enjoyed more autonomy after the resumption in 1961. The governor turnover rate was 0.16; there were 7 governors in 45 years and each governor assumed governorship, on average, for 6.4 years. During the "economic miracle" era between 1960 and 1990, there were only 3 governors; the turnover rate was 0.1 and each governor enjoyed the governorship, on average, for 10 years.

Those three tables show that the turnover rates changed from 0.4 to 0.25 to 0.1, which suggests that the CBC sustained its institutional autonomy from political pressures. This is a stark contrast to Korea where there were 22 governors in the 55 years of the BOK history with a turnover rate of 0.4.

A caveat with the turnover rate is that a low rate might be possible when compliant central bank governors do what the government wants them to do in order to serve long terms of office. In the next sections I look into the CBC to see if central bankers actually wield power and enjoy autonomy from the government.

VII. Central Bankers' Power: "Still Powerful"

Frustrated, but learning from the hyperinflationary spiral in the Mainland, Chiang Kai-shek guaranteed the CBC authority over economic affairs ministers. He put the CBC under the direct jurisdiction of the Presidential Office, ranking higher than the MOF. In comparison, such an institutional arrangement is a rarity in the world (Shieh 1994: 14). Thus, the CBC did not have to respond to legislators' questioning during sessions of the Legislative Yuan while the other economic agencies had to suffer from political and administrative enquiries. The CBC was insulated from political pressure.

Furthermore, the Board of the CBC took the full responsibility for monetary, financial, and foreign exchange policies; it was actually the command center of economic policy-making in Taiwan. Although the Minister of Finance and the Minister of Economic Affairs were ex officio Board members, the CBC governors usually led the Board, coordinating policy differentials among the government branches. Since the KMT government's top priority was monetary and financial stability, the government fully supported the policies and rules that the CBC came up with. A professor (interview, summer of 2003, Taipei Taiwan) commented on the power of the governorship:

> During economic development periods up to the 1980s, the CBC was very powerful vis-à-vis other government agencies…. The first governor [Po-yuan Hsu] was a relative of Chiang Kai-shek, which suggests how much power the CBC governor had from the start since the power an official could enjoy was determined by the proximity to Chiang…. The power ranking was Chiang – premier – CBC governor in hierarchy. Kuo-hwa Yu was the most powerful man in CBC history. This way the CBC assumed the role of command center.

A characteristic of the KMT's strategy to implement industrialization was that economic planning agents did not enjoy autonomy as much as the EPB in Korea. Rather central bankers were always influential in the economic planning and implementation. Reshuffling economic agencies in 1973, Chiang Ching-kuo set up the Economic Planning Council (EPC) which had a weak chairman and did not wield power as a supraministerial shadow cabinet. EPC analyzed macroeconomic situations and offered projected economic plans to the government, but lacked substantial leverages to implement those plans.

Instead, Yu Kuo-hwa, a Central Bank of China (CBC) governor and Chiang family insider, held the real policy-making power as he headed a new "five-man Finance and Economic Small Group of the Executive Yuan (FESG)." Serving the CBC governorship for fifteen years (May 1969 to May 1984), Yu was one of a few high-ranking officials who could communicate directly with the president.

When the second oil crisis hit Taiwan, the KMT government felt it necessary to reorganize its economic planning authority scattered among a few agencies. In 1977 the government replaced the EPC and FESG with the "Council for Economic Planning and Development (CEPD)" consisting of economy-related ministers. It was a commanding height of industrialization policy making on the island, taking full charge of macro- and micro-planning, industrial financing, and sectoral coordination. Since the CEPD was under the sway of Yu, the policy preferences and choices of central bankers were influential in decisions the CEPD made (Gold 1986: 92, 102).

The revised CBC charter of 1979 stipulated, however, that it would be under the jurisdiction of the Executive Yuan (the Cabinet). The governor became subject to the legislators' monitoring and was questioned twice a year during the two sessions of the Legislative Yuan concerning the economic situation and monetary policy. In addition, the governors had to face an annual budget debate and respond to enquiries raised by legislators from both the Finance and Budgeting Committees of the Legislative Yuan. "Independence from government" during the 1960s and 1970s changed to "independence within government" after 1979.

Nevertheless, its independent role as a government bank and the highest monetary policy-making agency has not changed even with the change in jurisdiction. While the MOF is also partially in charge of financial administrative matters, the CBC is still totally responsible for the implementation of monetary and foreign exchange policy, and the financial supervision of the banking system in Taiwan. The positions of the CBC and the MOF have been parallel, especially since the 1990s (interview, summer of 2003, Taipei Taiwan). In comparative perspective, the CBC falls in between the U.S. where the Federal Reserve System is independent of the government, and Japan where the Bank of Japan is subordinate to the MOF (Shieh 1994: 15).

So far, I have discussed Taiwanese central bankers' independence by showing legal codes, turnover rate of governors, and their institutional position in the state. In the next section, I show how and why CBC's independence was sustainable in terms of socioeconomic arrangements as well as discuss its performance.

VIII. CBC: The Guardian of Economic Stability and Balance

How did industrial structures affect central bankers' independent implementation of monetary and financial policies in Taiwan? Although it is politicians who delegate to central bankers independence for realizing what they are supposed to do, domestic socioeconomic arrangement can also affect the CBI delegation. Did the Taiwan have social bases that are favorable for the KMT government to allow central bankers significant autonomy?

According to Table 3-11 in chapter 3, in 1991 shares of total manufacturing production in the size categories 1-9, 10-49, 50-99, 100-499, 500+ employees were 8.1, 22.6, 12.9, 29.5, 26.8 percent, respectively, in the early 1990s. In addition, Table 3-8 in the same chapter indicates that SME's share of export ranges from 59.2 to 69.7 percent with an average of 65.2 in 1981-1988. These statistics show that SMEs are prevalent in industrial sectors or, at least, countervailing the market power which the big industrialists maintain on the island.

SMEs may prefer cheap credits for their operations but their preference is weak and inconsistent compared to big industrialists. SMEs' assets are less specific and easier to move to alternative uses therefore they do not have as much incentive to lobby for more preferential policy loans as big industrialists do. Given that asset specificity is higher in industries with high barriers to entry and unique technology and skills, the KMT government's established policy for low entry barriers and exit costs helped the manufacturing sector have less asset specificity. Furthermore, the fact that SMEs in Taiwan are dispersed all over the island and their sector consists of large number of small units suggests that it is not easy to mobilize and organize their interests in order to bring pressures to bear onto the state.

There exist big firms in Taiwan whose assets were specific to the capital-intensive sector and who exert their strong lobby for cheap credit. But the émigré KMT government discouraged the growth of indigenous big industrialists by employing an anti-branching-out policy. As a result they are not a dominant actor in the market. Once big industrialists entered the heavy and chemical sectors, their power to lobby public policy in their favor was countervailed by SOEs and a myriad number of SMEs as evidenced by the petrochemical sector. In sum, the composition of the Taiwanese industrial structure prevented industrialists, large and small, from organizing their preferences and interests for cheap credits, a source of loose monetary control and high inflation.

The financial sector has a strong preference for price stability since inflation favors debtor over creditor; bankers and financiers do not like to see their assets values falling. Furthermore, until recently, most of all the commercial banks were owned by the KMT government. In other words, banks represented state capital itself. In this situation, high inflation would mean a disaster for the émigré government's economic power on the island: the government itself was the creditor. Thus, the Nationalist government and the CBC, the financial manager of state capital, tried their best to secure monetary and financial stability. A professor-turned legislator (interview, summer of 2003, Taipei Taiwan) commented that the relationship between commercial bankers and central bankers is:

> Basically they [commercial bankers] respect the CBC. That's because they know that CBC have been discouraging growth of NBFIs that are their major competitors in the financial market. Furthermore they understand that CBC has been effective in controlling inflation and NPL which is what they like to avoid. Some bankers complain the CBC for its restrictive regulation policy due to which they cannot venture into new financial operation especially in 1990s. But they came to understand after 1997 Asian crisis that those strict regulatory measures may be necessary.

Governments of developing countries may want to channel financial resources into the private sector when they own or control banks. So why did the KMT government not pour its resources into the private sector to speed up economic growth when it could do so? This alternative choice was blocked on the part of the mainlander minority government due to their political distrust of local capitalists. In this sense, a counterfactual explanation suggests that even with the traumatic experiences of hyperinflationary spirals in the mainland, the Nationalists might have adopted the Korean path if the mainlander industrialists had crossed the Taiwan Strait with the KMT.

Taiwanese farmers, as producers, prefer cheap farming credits but they prefer price stability as sellers of seasonally fluctuating agro-products fluctuating seasonally and as consumers of industrial products. In addition, they are scattered all over the island and are usually small-holders due to the successful land reform. The crosscutting of interests, geographic dispersion, and large-number-of-small-unit problems dictate their weak and inconsistent preference for monetary stability.

Organized workers usually have the same preferences as the industrialists since their welfare often depends on the profitability of the sector which they are in. But their preference toward inflation is weak and inconsistent due to their cross-cutting interest as consumers. As chapter 3 explains, Taiwanese workers are not organized into labor unions due to SMEs-dominant industrial structure and myriad of occupational unions.

Although subordinate groups like farmers and workers have weak monetary and financial preferences, they are a majority of the workforce and can counterbalance the desires of unbalanced but seedy economic development. As discussed in chapter 3, the Nationalists' broad developmental coalition included the subordinate groups, at least at the socioeconomic level. Since siding with a special interest becomes costlier if number of coalition partners increase, the KMT government maintained a "distant and fair" attitude toward each group that was in the coalition. Thus the government delegated monetary and financial authority to the central bankers. Furthermore, the CEPD case shows that although the government had developmental technocrats in its officialdom, political leadership invited central bankers supervising economic planning and implementing authority.

The subordinate status of big private bourgeoisie, SMEs-oriented industry, state-bank nexus, and the inclusion of subordinate groups into broad but loose developmental coalitions contributed to socioeconomic arrangements conducive to the emergence of an independent central banking system in Taiwan during the "economic miracle." Central bankers were not seriously pressured by societal interest groups for cheap preferential credits and thus loose monetary and financial regulation.

According to Charles S. Maier, who tries to demystify monetarist notion of inflation, "the granting of price and wage claims beyond the given money value of the national product produces inflation" which is "one of the major forms of distributive conflicts in contemporary society." The prerequisite for low inflation is the "balance of social forces" and "economic growth pursed in an effort to reconcile all important social groups" (Maier 1978: 41, 59). If that was the case, one should see that the CBC was independent and good at controlling inflation within tolerable limits since Taiwan registered a balanced growth strategy and a broad but loose developmental coalition.

The CBC's performance was outstanding in keeping the national economy stable. Figure 4-3 graphically shows inflation rates, measured by the annual change in GDP deflators, in Taiwan, in comparison with OECD countries for three decades. GSUS refers to Germany, Switzerland, and the U.S., where central bankers are known to be the most powerful and autonomous in the world. Taiwan averaged 5.7 percent inflation during the three decades, while OECD member countries and the GSUS averaged 8.4 and 4.3 percent, respectively. In general, the GSUS did better than the Taiwanese central bankers who, though, performed far better than average OECD countries.

As a small open economy, Taiwan depends heavily on exports, which suggests that the island is more subject to changes in the world market than other big countries with large domestic markets. Thus, the inflation rate skyrocketed in 1973-4 and 1979-80, mainly due to the first and second oil shocks. The two peaks of inflation in the 1970s did not come from inability or policy failure on the part of the central bankers in Taipei. If we exclude these two peak years, the CBC has been more successful than the OECD and GSUS in maintaining economic stability: the Taipei central bankers sustained, on average, a 3.72 percent increase in inflation, while the OECD and GSUS experienced 7.73 and 3.99, respectively.

In fact, the central bankers extended cheap credits to various sectors in order to boost economic growth. But they cruised skillfully between Scylla in ignoring sectoral needs for financial resources and the Charybdis of being captured by private narrow interests.

Given that the CBC charter officially stipulated that it has to "foster economic development" [Article 2], the central bankers have been active in extending preferential credits to sectors. The CBC has often adopted selective credit financing measures by allowing commercial banks to provide low-interest loans for exports and to obtain re-accommodation for the CBC. In addition, the central bankers made efforts to mobilize financial resources from savers into a pool of industrial funds. For instance, the CBC used the postal savings system to meet the needs of long-term industrial projects. The branches of the postal service agency all over the island accepted savings deposits as well as time deposits from the general public, although the central bankers prohibited the agency from gaining profits through loan extensions at its own discretion. The CBC ordered that most of the agency's deposits had to be redeposited into an account at the CBC, and then used the postal savings for a "Special Fund for Medium- and Long-Term Credit" to satisfy industrial financing (Shieh 1994: 26).

It should be noted, however, that the Taiwanese central bankers' loan extensions are different from those of their Korean counterparts, which have often selectively provided low-interest and long-term "special credits" to financially insolvent banks and firms. The CBC followed the KMT government's prudential financing policy, such as the "six criteria of credit extension," which includes "a big value-added effect, a big forward-backward linkage effect, high market potential, high technology intensity, low energy consumption, and low environmental pollution" (Shieh 1994: 25). Those products selected with these characteristics consisted mainly of products from mechanical, information, electronics, biochemical, and material industries.

The distribution and management of CBC credit has been based on a sector-wide plan, not a specific firm-by-firm plan. Since a large number of SMEs constitutes a certain sector, the CBC's credit extension could not selectively favor certain firms in the sector. There were not many big firms, even if funded, that could boost the sector-wide performance as in Korea. The CBC cooperated with the KMT government in observing "field manipulation," by which they appeared relatively neutral to sectoral or regional interests. In this sense, the CBC observed the Bagehot's principle (1878) stipulating the central bankers' neutrality and fairness: the CBC protected not individual firms but the market in general.

Furthermore, industrial credit extension has remained relatively inconsistent and temporary. When the economic ministries asked the CBC for more financial mobilization for their industrial plans, “the conservative Board directors at the CBC hesitated using their policy tools for helping spending agencies” (interview, summer of 2003, Taipei Taiwan). In addition, even if there were various kinds of selective credit policy measures, their total amounts were quite small in terms of the percentage of the CBC’s total assets. The amount was consistently below 10 percent during the period from the 1960s to the early 1990s (Shieh 1994: 25).

IX. CBC’s Supervision in the Financial Liberalization

How can central bankers sustain their leadership in the globalization era when the market pressures all government agencies to shed their regulatory authority? The Taiwanese central bankers’ responses to the ever-increasing pressures of financial liberalization were 1) discouraging non-bank financial institutions (NBFIs), 2) strategic withdrawal from non-bank financial institutions, 3) cooperation with the MOF, and 4) restructuring the financial supervisory system.

First, the CBC was skillful in maintaining its financial constituents. As financial liberalization tends to introduce non-traditional financial intermediaries to meet the diversified needs of the market, NBFIs including merchant banks, investment companies, credit co-ops, money markets, and insurance companies started to operate in Taiwan in the mid-1980s. The conservative CBC, as “the bank of banks,” made discouraged those NBFIs from flourishing and dominating the Taiwan financial community. They wanted commercial banks to keep dominating the market since they were under the central bankers’ jurisdiction and those banks were the central bankers’ social base in the financial community.

Table 4-9 shows that the central bankers’ aforementioned efforts were successful. Although the full-service banks’ share of the total loans and investments decreased from 82.0 percent in 1961 to 68.3 in 1990, they still controlled quite a majority of loans and investments, almost seventy percent of the financial resources available in Taiwan during 1990. Foreign banks, investment and trust companies, and insurance companies still comprised a small amount of the market share. Their shares in 2001 were 3.0 percent, 1.0, and 5.5, respectively. The share of investment and trust firms nosedived after the

Asian crisis. SME banks, credit co-ops, and accounts at farmers/fishermen's associations and Chunghwa Post constituted 10.0 percent, 9.2, 6.3, and 0.2 , respectively, in 1990.

The second reaction of the conservative CBC to financial liberalization was a strategic withdrawal from covering NBFIs. Originally the central bankers supervised all the financial intermediaries as their charter stipulated in Article 38. But financial and political liberalization since the mid-1980s allowed some indigenous Taiwanese financiers to establish new financial firms that were often aggressive and risk-taking in their asset management. "They are not experienced and skillful in dealing with financial transactions compared to established bankers who used to follow prudential loan extension before the financial liberalization" (interview, summer of 2003, Taipei Taiwan).

As globalization tends to foster and diversify NBFIs, some of which often falling into poor performance or even insolvency, the central bankers chose to strategically take NBFIs out of their jurisdiction in 1991. The CBC wanted to "pass bugs" to other agencies. As a mid-level CBC official (interview, summer of 2003, Taipei Taiwan) said, "The CBC wanted to stay away from the possible trouble makers." When the MOF licensed 16 new banks and 14 financial holding companies in 1991, the central bankers concluded a deal with the MOF for a "division of labor" in financial regulation and supervision. The CBC covered domestic private banks established before 1991 and foreign banks; the MOF took charge of all new banks set up after 1991, the stock market, and all private financing companies; and Central Deposit Insurance Corporation (CDIC) had in its jurisdiction the SME banks and community financial intermediaries like local credit co-ops and credit departments of farmers' and fishermen's associations. A legislator of an opposition party and top officials at CDIC, respectively, commented about the compromise among the state agencies:

> Old banks established before 1991 were big commercial banks, while post-1991 banks were new and small banks. Since new banks often had liquidity problems or even insolvency, the CBC did not want to get involved in their financial turmoil. It was strategic non-involvement…. The Bureau of Monetary Affairs (BOMA) at the MOF chartered new banks and they liked to increase their financial power through their constituent banks and private firms of insurance, investment, and trust….

> So both parts, the CBC and BOMA, agreed with the division of labor in financial regulation and supervision. (interview, summer of 2003, Taipei Taiwan)

> Originally, we did not want to take charge of small local credit institutions because they were not skillful in dealing with sophisticated financial transactions…. They were often in bad situations. For example, farmers did fierce collective action last year [in 2002] due to their agricultural association's bankruptcy as well as massive imports of agricultural products. But we could not help accepting the division of labor, since we were under control of the MOF. The CBC also controls us as a big shareholder of the CDIC. (interview, summer of 2003, Taipei Taiwan)

Thanks to the division-of-labor agreement, central bankers "passed bugs" to the MOF so they could keep their major constituents, big commercial banks, performing well. On the other hand, the MOF, by taking over nonbanks, could increase its constituents in its jurisdiction exerting regulatory power over ever increasing NBFIs in this global era.

It should be noted that even with the agreement, the CBC still plays a critical role in the financial sector in terms of its constituents: commercial banks are well functioning and intermediate almost 70 percent of national wealth; foreign banks mainly from the U.S., Japan, France and Germany are vital to the small island since they relieve the KMT government of diplomatic isolation from the world; overseas Chinese capitals in Southeast Asia, if not attracted, may shift their investments and loyalty to mainland China. Central bankers have financially and politically important constituents in their jurisdiction. In contrast, the MOF has small and new NBFIs in its jurisdiction that are, although promising in the future, still infant industries that lack financial expertise. The CDIC has in its jurisdiction local small financial intermediaries that still lack financial skills often falling into insolvency. In a nutshell, the power hierarchy runs in the order of CBC to MOF to CDIC in terms of constituent intermediaries.

Does the CBC-MOF division of labor usher in institutional compartmentalization or policy conflicts over financial regulations? According to my interviews with officials at the BOMA, CBC, and CDIC, there seem to be not many policy debates or conflicts among those three agencies. A mid-level official (interview, summer of 2003, Taipei Taiwan) at the BOMA says:

> There is no big problem with the policy coordination. We share financial reports of various kinds with them. Also, we set up a joint committee to deal with problems in financial policy implementation. The committee gets together once a month.

Indeed, there were concerted efforts at prudential regulation among those government agencies. To gain a grasp of the operating status and financial conditions of risk management at all financial intermediaries, the MOF, CBC, CDIC, and Taiwan Cooperative Bank together organized the "Financial Examination Task Review Committee" as early as in 1986. Furthermore, the MOF commissioned the CDIC to set up a "National Financial Early Warning System" that enabled all relevant state agencies to share detailed information about all financial intermediaries' business operations. Showing the system running on his desktop computer to the author, the CDIC president (interview, summer of 2003, Taipei Taiwan) proudly said:

> We share information with the CBC and MOF through the system, which started 5 years ago [in the summer of 1998]. The member financial institutions are required to report once a day what we like to know. Our supervisors examine their reports before they are allowed to update their data online.

In addition to the CBC's concerted operation with the MOF, the central bankers divested themselves of financial supervisory authority to set up the Financial Supervisory Commission (FSC) in July 2004. The FSC took supervisory officials dispersed throughout the CBC, MOF, and CDIC, launching an integrated independent government agency. The financial officialdom in Taiwan today is a tripartite format consisting of the FSC, CBC, and MOF all of which are enjoying equal legal and political status.

Why did the government delegate financial supervisory authority to the FSC? Why did central bankers agree with the delegation? "After the Financial Holding Company Act was passed in June 2001, the MOF found itself facing a growing challenge generated by the ever-increasing mergers and alliances among financial institutions."[16] The CBC also felt it was more complicated and difficult to supervise the commercial banks in its own jurisdiction since they got involved in a densely knit financial network with the NBFIs and foreign private capital.[17] The central bankers were ready to shed their supervisory overloads. This is a typical case of a "solution of delegation" (Elster 1979: 61, 89).

It should be noted, however, that their efforts for the FSC were motivated by Korea which had established the Financial Supervisory Service (KFSS) two years ago in January 1999. The Korean financial industry faltered during the Asian crisis of late 1997 but recovered to normalcy in a very short time; this was the KFSS' contribution. Impressed by the Korean experience, the Taiwan government seriously pushed for an integrated independent agency for financial supervision. A top official (interview, summer of 2003, Taipei Taiwan) of the CDIC confessed, "We learned a lot from the preceding Korean experience. We're closely watching what's happening in Korea."

Compared to the Korean case, where financial regulation and supervision was a historical battlefield between the MOF and BOK, Taiwan's experience showed a smooth institutional transformation to an independent supervisory agency. The FSC was a product of the MOF-CBC "pact". Both parties understood that they had to solve the ever-increasing financial volatility and agreed that it was necessary to delegate their supervisory authority to the third party.

The smooth transformation was, however, possible due to the fact that the Taiwanese government solved the problem of staff salaries before the initiation of the FSS, while the Korean government still suffers from the problem. Given that the CBC staff's monthly wage was higher than that of any other government officials, they must have resisted their relocation to the new FSS if the government had not guaranteed the same amount of money. A mid-level official (interview, summer of 2003, Taipei Taiwan) at the CBC said, "We already solved the salary problem. The government promised us to

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16 Financial Supervisory commission's website (http://www.fscey.gov.tw/ct.asp?xItem=659838&ctNode=453&mp=5). Accessed Sept. 27, 2005.

17 Central Bank of China's website (http://www.cbc.gov.tw/Enghome/default.asp). Accessed Sept. 27, 2005.

guarantee highly competitive salaries, which is good for us. Most of my department members are expected to go to the FSS next year [July 2004].”

In the case of Korea, the wage gap between the KFSC and the KFSS is one of the behind-the-scene reasons that their policy conflicts continue to exist. To solve the organizational duality, the government once suggested to the KFSS, in secrecy, to transform it from a private organization to a civil servant one; the government wanted to absorb KFSS into the state bureaucracy. The KFSS’ reaction was negative. A director (interview, summer of 2003, Seoul Korea) at the MOFE said:

> They [KFSS] argue that they could not exercise fair supervisory authority if they join the KFSC which they believe to be politically dependent. But it’s not true. They fear that their high wages must be lowered if they become civil servants. The KFSS labor unionists do not like it. If they had accepted the offer, they should have been blamed by their own members. In this sense, it’s all about politics.

Is there any difference in the two East Asian rivals in terms of supervisory autonomy? First, the FSC is an independent single-unit agency affiliated with Executive Yuan, enjoying legal status equal to the CBC and the MOF (FSC 2004). In fact, Taiwanese officials learned from their Korean predecessors and thus avoided conflicts from the organizational duality. A top official at the CDIC (interview, summer of 2003, Taipei Taiwan) once confessed:

> We know that the Korean supervisory system currently suffers from conflicts between the KFSC and the KFSS. Senior officials at the KDIC (Korean Deposit Insurance Corporation) dropped by my office last week. They told us about it. We are currently discussing how to establish an organizational format so we can keep away from that kind of problem.

In contrast, the KFSS is under the jurisdiction of the KFSC, which is the organizational origin of the conflicts between the government trying to control financial supervision and the KFSS seeking for institutional autonomy. A director at the MOFE (interview, summer of 2003, Seoul Korea) complained in the middle of my interview saying:

> Our legal system follows the continental tradition, not the Anglo-Saxon one. It is impossible to delegate the public function of financial supervision to a private organization, the KFSS. I don't like the KFSS' attitude. They mistakenly believe that they have to have power to do something. They always interrupt our business.

Second, as Table 4-3 shows, the KFSS chairmen have been recruited from retired or current senior officials at the MOFE, which suggests that the KFSS is an extension of developmental technocrats in terms of personal connections. In Taiwan, among the 9 commissioners including the chairman, 3 came from the private sector, 4 from university faculty, 1 from legal circles, and only 1 from the MOF.[18] Most commissioners were recruited from the non-government sector, which contributed to separate personnel networks and thus autonomous supervisory operations.

X. Conclusion: Independent CBC vs. Dependent BOK

So far I have discussed how and why the central banking systems in Korea and Taiwan went through different historical paths – the "independence" path for Taiwan vs. the "dependence" one in Korea.

The military government did away with the 1962 financial system the BOK that had been established by liberal American finance drafters. Since then, central bankers have not been able to perform what they were supposed to do during industrialization. They were on a tight leash controlled by the MOF and developmental technocrats who made coalitions with big industrialists for rapid and unbalanced economic growth. Powerful big industrialists nurtured by the state, timid commercial bankers controlled by the developmental bureaucrats, and subordinate groups ignored by the state constituted an unfavorable socioeconomic constellation that the central bankers had to face.

I have shown that Korean central bankers were dependent by looking into legal codes, governor turnover, actual power status within the state apparatus, and its policy performance including inflation and NPL. Furthermore they were not effective at regulating and supervising financial intermediaries' risk-taking operations since the BOK was troubled by conflicts with MOFE, the "developmental dinosaur."

Frustrated by and learning from inflationary spiral in the mainland, the KMT government fully supported central bankers when the CBC resumed its operation in 1961. The CBC charter was less specific than its Korean counterpart but provided central bankers with "room for policy maneuver" and CBC governors were guaranteed their terms of office during successful industrialization. Central bankers were responsible for a full range of monetary and financial policy areas delegated by the government. Furthermore, during industrial deepening in the 1970s, central bankers were invited to supervise the CEPD, the commanding height of economic planning and sectoral coordination. In the 1980s and 1990s central bankers in Taipei reacted strategically to a changing financial environment: they cooperated with other agencies, drew a deal for a division-of-labor, and delegated supervisory overburdens to a third independent agency, but still lead the financial community on the island.

In addition, the central bankers found themselves in a balanced environment favorable for their autonomy. As Taiwan experienced balanced economic growth with stability, there was a broad but loose coalition in society: the lack of conquering big bourgeoisie, myriad of SMEs, a strong financial sector sponsored and controlled by the KMT government, and farmers and workers not organized but more or less enjoying developmental benefits. This socioeconomic arrangement was a favorable social base for central bankers' autonomy.

I have shown in chapters 2, 3, and 4 how and why these two governments' different coalitions with different sectors contributed to varying levels of autonomy that central bankers have enjoyed in these two countries. The next chapter asks if my argument confirmed in my two cases studies are applicable in the context of Southeast Asian countries.

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[18] Visit FSC's website (http://www.fscey.gov.tw/ct.asp?xItem=636241&CtNode=2316&mp=5). Accessed on August 11, 2005. Two commissioners from private sector started their career as civil servants, and one commissioner with background of professorship used to be in private sector as well as officialdom.

Chapter 5: Central Banking Systems in Comparative Perspective: Singapore, Thailand, and Malaysia

Singapore weathered the storm of the Asian financial crisis that hit the region in 1997, while Thailand and Malaysia suffered great losses national wealth and psychological damage. This chapter addresses the generalizability of my arguments, detailed in two cases studies, by exploring three Southeast Asian countries. What contributed to each country's political choice of the developmental strategy within which a central banking system operated? What were the social bases of the central banking systems? How different were the central banks in maintaining their monetary and financial regimes when the storm threatened to engulf the region?

The first section explores the Singaporean case, discussing ruling politicians' concerns over separation from Malaysia and how this spilled over into their strategy of coalition making and economic development. The latter half of the first section addresses the Singaporean central banking system in a small entrepôt state trying to attract capital, domestic and foreign, yet keeping its financial regime stable and prudent.

The second section explores the Malay case. The first half discusses how and why the ruling party chose a specific partner among diverse ethnic groups for its economic growth. The latter half looks into the Malay CBI detailing the legal stipulations of the central bank charter, turnover of central bank governors, actual positions that central bankers at Kuala Lumpur have in officialdom, and their performance.

The last section investigates the central banking politics in Bangkok, Thailand, where the regional crisis started. Its first part focuses on the social bases of Thai economic growth under the condition of frequent government changes. Examining legal codes, turnover of governorship, central bankers' power relationship with the finance ministry, and central bankers' accomplishments, the latter half analyzes the Thai central banking system's independence and its financial regulation.

I. Singapore: Trauma, Broad Coalition, and Prudential Finance in the Entrepôt

Traumatic Expulsion and Inclusive Developmental Regime

Singapore was a British colony after 1824, as part of an administrative unit known as the Straits Settlements, which included Penang and Malacca (now modern Malaysia). Malaysia received full independence in 1957, and two years later Singapore was granted self-governing status within the Malay government for all matters except defense and foreign affairs. The vociferous rhetoric of the Lee Kuan Yew government (1959-1990) arguing for rapid economic development of Malaysia annoyed Kuala Lumpur leaders, raising disputes over governmental spending and representation of the states in the Malay federal parliament (Haas 2001: 67).

In fact, Singapore, a largely Chinese urban center of Southeast Asia, did not have a good relationship with the Federation of Malaysia, where indigenous Malays were the majority in ethnic terms but less privileged than the Chinese in socio-economic terms. Ethnic conflicts were dominant during the nation-building period after independence. Finally, the debates and conflicts led the Malay government to expel Singapore from the Federation. Lee lobbied long and hard for Singapore to remain in the federation so that his country would be a part of the larger economic market and would enjoy national security, but Malaysia still showed the cold shoulder to the tiny entrepôt (Haas 2001: 67).

Singapore's expulsion from Malaysia in 1965 was a historical trauma that caused mass psychological and national insecurity and threatened socio-economic collapse. One example demonstrates the insecurity that the entrepôt-state faced: Singapore depended entirely on water resources imported from Malaysia, and any problems with the water supply or quality could damage the city-state.

To make matters worse, Singapore's political leadership had to build a nation out of an ethnically diverse immigrant society given to individualistic pursuits. "The constant in- and out-flow of immigrants meant the society was imbued with the characteristic preoccupation of short-term goals and a reliance on extensive intra-group social networks" (Fong 1988: 221). The historical trauma led to "the politics of survival, a set of policies and strategies aimed at curbing domestic dissent, promoting stability, and industrial peace to attract much-needed foreign investment while instilling in the island's ethnically diverse population a sense of national identity"(Chee 1971).

How did the political leaders decide how to build the nation and grow the economy? They chose to integrate heterogeneous social groups into the political system. The People's Action Party (PAP), the ruling party of the Lee government, emerged as an anti-colonial and socialist party in 1954 when the Peking-led communist ideology was widespread among Chinese workers in the entrepôt. After leftist extremists left the PAP in 1961, the party changed its political base from workers to a multi-racial, multi-lingual, and multicultural mass. The editorial of the *Petir* opined in 1963:

> As a non-Communist socialist party, the base of our party remains firmly rooted in the working class. It cannot be otherwise. But at the same time we must enlarge our scope and pay equal attention to other groups in our society. It is only in this way that the party can change its emphasis from a purely working class movement to a national movement with a broader base…. The aspirations of all classes and communities must therefore find expression in the policy and activities of the Party. (Lian 1971: 72)

Transforming the party into a "party of integration," the PAP leadership swept the general election of 1963, a "critical election" in the sense that it defined the party's coalitional politics and froze Singaporeans' voting behavior up to the present. In comparison, its closest counterpart may be the Mexican Party of Revolutionary Institutions (PRI), which until the 1990s was victorious in virtually all elections even though other parties existed and were legal. The PAP developed its party membership to reflect the racial composition of the society, so the party reflected social diversity. In 1966, Singapore's demographic compositions by race were Chinese (78.7%), Malays (12.1%), Indians (6.6%), others (2.5%); the PAP membership roughly reflected the racial shares: Chinese (67.9%), Malays (14.0%), Indians (16.5%), and others (1.6%) (Lian 1971: 52).

The PAP government integrated the racial groups mainly through education and housing policies. It expanded educational opportunities based on a multilingual – Chinese, Malay, and Tamil languages – educational system with English as a second language, and steered students into technical and vocational studies. The parallel educational system assured the population that cultural diversity would be respected. In addition, the Parliament accepted a quota system for minorities, allocating them public housing facilities. These efforts led 86 percent of the total population to live in their own houses, and prevented the growth of ethnic residential enclaves (Haas 2001: 71). The primary goal of the public housing program was to "win the electoral support of the population by providing decent and affordable housing, with a secondary goal of building a sense of community and national commitment through financing occupants' ownership of their public housing units" (Lim 1999: 110).

The financial sector was one of the main pillars supporting the Singaporean developmental coalition. Since the Singaporean government faced economic and national insecurity, it started economic development with an eye towards taking advantage of its entrepôt status: Singapore was traditionally a hub of financial transactions in Southeast Asia during the British colonial era. After a few years of inward economic development which failed in the 1950s, Goh Keng Swee, the Minister of Finance, persuaded the political leadership to embark on industrial development based on foreign capital. The problem was "how to attract foreign capital and make it flow through the city-state." The Lee government's strategy was to set up an efficient financial infrastructure to exploit the maximum creditworthiness in the eyes of international investors. The government and the People's Action Party (PAP) regarded a stable and efficient financial system as a core of their political and national survival from. Figure 5-1 shows that their efforts were successful.

Financial growth proxied by M2 as a percentage of the GDP was spectacular in Singapore, even in the early 1960s. In 1964, money intermediated through financial institutions was 58 percent of the GDP for Singapore, 23.7 for Malaysia, 21.0 for Thailand, and 8.4 for Korea. The level of financial development that Singapore reached in the early 1960s was achieved by Malaysia in 1985, Thailand in 1989, and Korea in 1999.

Since 1968, when Singapore started to attract offshore banks, it has hosted one of the largest offshore financial markets in the world, the Asian Dollar Market. Therefore, the tiny city-state played a key part in channeling capital to corporations and government agencies for development in the Asian region. This success also made the tiny city-state rank fourth behind London, New York, and Tokyo in foreign exchange dealing, and fifth in terms of derivatives trading (Peebles and Wilson 2002: 203).

Were workers invited to the developmental coalition? The PAP government, committed to a social democratic ideology in the early years, incorporated labor during its industrialization. The government employed a tripartite system, consisting of representatives of government, employers, and labor, to determine labor policy issues. Workers' wage is determined by the National Wages Council which recommend nominal wage increase for the entire economy once a year. Its wage guidelines were not legally compulsory, but leading public sector respected it and private firms usually followed (Yuan 1987: 174).

The material base of labor integration was the Central Provident Fund (CPF), a compulsory savings scheme paid by employers and employees. The contribution rates have been fixed at around 15-20 percent of the salaries for both employees and employers (Hamilton-Hart 2002: 94). The balances in each member's account were usually available for withdrawal at the age of 55 or on leaving Singapore permanently (Peebles and Wilson 2002: 88). The government-operated CPF were used for public housing, welfare needs, and retirement pensions. It was also used for a public investment fund providing the government with a low-cost source of non-inflationary finance.

On the other hand, labor shortages and full employment that Singapore experienced as early as the 1970s pressured the government to import foreign manpower. Unlike Hong Kong, the PAP government adopted an increasingly restrictive and selective immigration policy to attract votes from workers. Unskilled immigrants often handled menial jobs, leaving employment in the skilled occupations to Singaporeans.

It should be noted, however, that the government did discourage workers' organizations outside the control of the PAP. The mass party's politics registered seemingly as a benevolent state-corporatist scheme, preempting autonomous spaces for workers by guaranteeing material benefits. The official discourse of the PAP has always been pro-labor in a social democratic sense, which encouraged working class formation "within the state." There were no viable opposition parties that could countermobilize workers in such a small harbor-state.

Although the Economic Development Board (EDB), an economic planning agency, guided industrial strategies since 1961, Singapore did not develop big industrialists comparable to the Korean chaebols. Instead, the entrepôt-state relied on foreign and public industrialists. In the export-manufacturing sector, an economic pillar on par with finance, foreign-owned firms conducted 65 percent of all direct exports and foreign-controlled enterprise (i.e., those with more than 50 percent foreign equity) accounted for another 16 percent in 1984. Purely domestic firms only provided 11 percent of the total exports. The capital-intensive sector was dominated by foreign industrialists and investors (Krause 1987a: 69). The sector featured high asset specificity but firms in it did not bring much pressure on the government, since "foreign" investors could go out of market by withdrawing their capital. In Hirschman's terms (1970), they did not resort to "voice" because they have another strategy, "exit."

State-owned enterprises (SOEs) prevented the rise of big industrialists especially in capital-intensive sectors like metal products, machinery, transport equipment, chemicals, petroleum refinery, and steel. The public sector maintained a huge 64 percent of the gross national savings and employed 19.5 percent of the workforce in 1980. The sector accounted for 33.4 percent of the gross domestic fixed capital formation in 1984 (Krause 1987b: 116).

After the 1970s, the planning agency embarked on "high tech-intensive" industrialization, a new phase in the developmental path, given the fact that the city-state lacked labor and space. No longer would policies encourage the expansion of light industries that needed a large labor force. Instead, industrial policies encouraged investments in skill- and technology-intensive sectors such as computers, electronics, machinery, and pharmaceuticals, in order to generate more value-added from the same amount of labor. In sum, hi-tech-intensive and FDI- and SOEs-dominant industrialization strategies prevented a Korean-style big bourgeois from rising and pressuring the government in their favor.

The governmental characteristics promoted high CBI in Singapore. First, the PAP's dominant position did not entail bureaucratic corruption; civil servants did not use their status to seek personal benefits from the market. A recent study shows that Singapore is ranked the 5th "clean officialdom" in the world. Japan, Singapore, and Taiwan have fairly developed rational-legal bureaucracies, whereas Thailand, Korea, and

Malaysia show considerable deviations from the Weberian standard; Indonesia and the Philippines are generally judged the least Weberian of the Asian countries. [19]

Second, the Board was successful in mobilizing domestic financial resources, offering real positive interest rates and thus encouraging savings – a good way to foster investment without inflationary pressure. According to the World Bank, Singapore had an average savings rate equal to 45.5 percent of the GDP during the 1980s and 90s, and thus ranked the third in the world. Furthermore, from 1970 until today, the PAP government has never experienced deficit financing; the average difference between government revenue and its final expenditure during the period is 14.99 percent of GDP (World Bank 2003). High rates of savings and no budget deficits meant that political leaders did not have an incentive to exert pressures on the central bankers in order to cover the deficit.

Third, the Lee government did not make extensive use of direct measures such as licenses, quotas, or price control to influence private decision-making. In consequence, both producers and consumers in the city-state had to respond to price signals from world markets. Because their governments avoided direct measures, powerful interest groups dependent on licenses and official favors did not grow and entrench themselves. Instead, Singapore emphasized policies that benefited the general public rather than some specific interest group (Fong 1988: 236).

In sum, Singapore has very favorable conditions for high CBI: a broad but loose developmental coalition, its position as the financial center of the region, no capital-intensive private industrialists, labor integrated into the state, and Weberian bureaucrats. In addition, the size and geographic position of the city-state might have affected the Singaporean developmental coalition. The entrepôt-state is tiny enough for the PAP government to regulate and permeate the "nation," compared to large countries where regional and social interests complicate the government's ability to integrate those heterogeneous groups into the political system. As for its geographic location, Singapore is positioned at the center of economic transactions both among Southeast Asia and between Northeast economies (i.e., Japan, China, Taiwan, and Korea) and Middle East

[19] Visit Transparency International (http://www.transparency.org/cpi/2004/cpi2004.en.html) for corruption

oil exporters. The PAP government could exploit those conditions to build its developmental project. The next sub-section explores the central banking system in the harbor-city, Singapore. Did the social bases of the coalition actually contribute to central bankers' independent authority to regulate the monetary and financial regimes?

Autonomous Central Bankers and Prudential Financial System

At the time of independence from Malaysia, various monetary functions associated with a central bank were performed by several government departments and agencies. In the late 1960s, the labor force was exhausted, the M2 approached 60% of the GDP, and the light industrialization was saturated. The PAP government planed to deepen the economic structure toward capital- and high technology-intensive industrialization, attracting foreign financial resources for its political survival. Thus, the country wanted to establish an efficient and integrated financial and monetary control tower to guide its economy. The government collected financial/monetary functions and personnel dispersed among government agencies to set up a central banking system. The Parliament passed the Monetary Authority of Singapore (MAS) Act leading to the formation of the MAS, the de facto central bank, on the first day of 1971.[20]

Like the Central Bank of China Act, the MAS Act provided the central bankers with broad authorization. The MAS [Article 4] had various functions: 1) acting as the financial agent of the government; 2) promoting stable monetary control, credit extension, and foreign exchange; 3) fostering a sound and progressive financial sector; and 4) issuing currency notes and coins. The broad coverage was mainly due to the PAP government's decision to empower the MAS as Singapore developed its financial sector. In 1971, the Ministry of Finance (MOF) transferred to the MAS all the functions and powers of the Commissioner of Banking, the Commissioner for Finance Companies, and the Controller of Foreign Exchange [Article 21 Section 1]. Again, in 1984 the MOF empowered the MAS by transferring more authority to regulate the non-bank financial intermediaries (NBFIs). The MAS assumed the powers of the Commissioner of

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index. Accessed on August 15, 2005.

20 MAS' website (http://www.mas.gov.sg/masmcm/bin/pt1Home.htm). Accessed August 4, 2005.

Insurance, the Registrar of Companies, and the Accountant-General under the Security Industry Act [Article 21, Section 2].[21]

The charter also protected MAS staff from possible hostile actions from the constituent financial firms against the MAS. Article 21 specified "no action, suit or other legal proceedings shall lie against any director, officer, or employee of the MAS; there shall be no legal action for anything done or omitted to be done in the MAS' employees' good faith." [22]

The Act guaranteed the MAS autonomy. The chairman was appointed by the president on the recommendation of the cabinet. Interestingly enough, Article 8 specified "the directors shall not act as delegates on the Board from any commercial, financial, agricultural, industrial or other interests with which they may be connected."[23] In Korea, the BOK charter specified the members of the Monetary Board including representatives of agriculture, industry, and the financial sector so as to improve democratic representation of interest politics into the central banking system [Article 8]. The MAS charter eliminated interest group politics from central banking function.

It should be noted, however, that the MOF controlled the Singaporean central bankers. The MOF minister recommended the MAS chairman to the president who then appointed him. Furthermore, the MOF Minister himself sometimes assumed the MAS chairmanship (Hamilton-Hart 2002: 89). Dose this mean there was a gap between the aforementioned legal CBI and the actual CBI in the central banking system?

The Singaporean central bank-MOF relation is that the MAS has danced with the MOF to conservative monetary and financial music. According to Hamilton-Hart, although the MAS chairman and the Board of Directors were under the control of the MOF, they rarely had inter-agency conflicts. Rather, the MOF's policy protected the MAS from the Economic Development Board (EDB), the architect of Singaporean industrialization. For instance, the MOF guaranteed the MAS' independence by

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[21] MAS website (http://www.mas.gov.sg/masmcm/bin/pt1Monetary_Authority_of_Singapore_Act.htm). Accessed on August 4, 2005.

[22] MAS website (http://www.mas.gov.sg/masmcm/bin/pt1Monetary_Authority_of_Singapore_Act.htm). Accessed on August 4, 2005.

[23] MAS website (http://www.mas.gov.sg/masmcm/bin/pt1Monetary_Authority_of_Singapore_Act.htm). Accessed on August 4, 2005.

separating the central bankers' role of financial regulation and supervision from the industrial policy role of the EDB (Hamilton-Hart 2002: 98). The MAS-MOF coordination vis-à-vis other state spending and planning agencies was possible because of the political context where the financial stability was the core interest in the eyes of the PAP leadership.

The turnover of the central bank governorship reflects the MAS' independence backed by the MOF. Table 5-1 lists the MAS chairmen over the years since its inception. The table shows the low turnover rate of the central bank chairmanship. There have been 5 governors for 34 years. The turnover rate measured by the number of governor a year is 0.147 per year. Chairmen served, on average, 6.8 years. In comparison, the turnover rate is roughly the same as the Taiwan central bankers (i.e., 0.1 a year during economic miracle era between 1960 and 1990). The Singaporean turnover is much lower than the Korean one, 0.4 governors a year.

I assume that independent central bankers will produce better results than subservient ones. Indeed, the Singaporean case supports my assumption. Figure 5-2 illustrates MAS' feat in maintaining the supply of money in the financial hub of the region. The average rate of inflation for Singapore from 1961 to 1990 is 3.37 percent of the annual changes in prices while countries with world-known independent central banks (Germany, Switzerland, and the U.S.) averaged 4.28.

On the other hand, the MAS took full responsibility of financial supervision of all financial institutions, even foreign non-bank financial intermediaries (NBFIs), which is a stark contrast to Thailand. After the Thai government hosted in 1993 offshore financial firms in its Bangkok International Banking Facility in a bid for regional economic hegemony, the central bankers in Bangkok stood idle by the footloose capital they attracted to the Facility (LoGerfo and Montinola 2001: 66-8). In contrast, central bankers in the harbor-state watched financial transactions closely.

The financial regulatory and supervisory agencies are under the jurisdiction of the MAS (MAS 1997/98: 16). Four MAS departments dealt with the affairs: the Supervisory Policy Department, the Banking Department, the Securities and Futures Department, and the Insurance Department. According to a recent study, the MAS regularly studied legislation to modify and remedy "gray" areas and "loopholes" to cope with the growing sophistication of the financial structure in Singapore. As one Singaporean Banker said, "the main actions MAS undertook during the international debt crisis in early 1980s were all part of a carefully thought out plan that demonstrated extreme caution and concern for the vulnerable individual investor" (Hamilton-Hart 2002: 87). The prudent financial system, backed by the MAS and MOF, helped the entrepôt city-state avoid the Asian crisis. While the crisis hit the region in late 1997, Singapore and Taiwan survived the storm that short-term speculative private capital caused.

II. Thailand: Financiers-Dominated Economy and the Rush to the Crisis

Government Captured by Finance Capital at Bangkok

People in Thailand were ethnically diverse, but the Thais constituted the majority at 75 percent of the total population. The Chinese were 14 percent and other various minorities were 11 percent. Ethnic Thais usually subsisted on paddy lands in rural areas, often expanding rice cultivation by clearing new lands. In contrast, Chinese immigrants controlled the financial and commercial functions critical to rice cultivation and marketing in urban centers. In the 1950s, ethnic Chinese constituted 70 percent of all business owners and senior mangers in Bangkok (Laothamatas 1994: 197).

By the late 1930s, the military faction within the People's Party, led by General Phibun Songkhram, controlled national politics. The Phibun government was characterized by xenophobic nationalism. It implemented programs designed to stimulate a Thai entrepreneurial class distinct from the Chinese, imposing limits on Chinese immigration and occupational eligibility while executing policies to establish state control of Thai industries and commerce (Connors 2001: 43). Furthermore, the nationalist government made serious efforts to establish state-owned enterprises (SOEs) to offset the ethic minority's economic power. Between 1932 and the mid-1950s, 90 state enterprises and public companies with substantial government holdings were launched in a series of attempts to "indigenize" the economy.

Relations between Chinese-dominated business and government began to change in the late 1950s with the advent of the Sarit regime, whose pro-market packages vigorously streamlined the government sector and placed trained liberal economists and technocrats in key policy positions. Sarit's market-oriented reform aimed to privatize state-owned enterprises (SOEs) which constituted a major political base for his rivals in the military (Laothamatas 1994: 199). In fact, the U.S. seriously recommended that the government stabilize and privatize the economy. The American officials threatened cutback of military aids if Sarit would not follow the recommendations. The market reform not only destroyed the former ruling elites of economic expansionist persuasion, but also promoted the private sector, especially the banking industry. In other words, the Sarit government's emphasis on "growth with economic stability" was a convergence of four relevant parties' interests: 1) Sarit's need to undermine his political competitors; 2) the U.S.' need to build a "showcase" state withstanding communist threats in Indo-China; 3) the Bangkok financiers' need to drive out an inefficient government sector from the market; and 4) the military's need to get more American aid (Phongpaichit and Baker 1995: 125-8).

Most of all, the post-Sarit government made a coalition with the commercial bankers in Bangkok whose businesses gained profits from their investments in agricultural exports (especially rice, tapioca, maize, and sugar) and the rice-milling industry, the backbone of Thai national wealth. Food export averaged 55 percent of the total export goods from the 1960s to the 1970s (World Bank 2003). Furthermore, commercial banker-controlled agro-export businesses helped support the fiscal balance of the government: trade tax amounted to 24.3 percent of the total revenue during the 1970s and 80s. The private bankers supported Thai rulers as their main political constituents while the government favored macroeconomic stability by not intervening in the monetary affairs of the BOT.

The political power of Bangkok bankers is based on two conditions. First, the Thai financial system has been dominated by a few commercial bankers. In 1970, commercial banks held 79.6 percent of total assets in the financial sector; in the 1980s, three banks, the Bangkok Bank, the Thai Farmers Bank, and the Krung Tahi Bank consistently topped the list, together accounting for 55-66 percent of total assets held by domestic banks (LoGerfo and Montinola 2001: 76-7). Figure 5-3 shows cross-national variation in banking concentration ratio in selected developing countries measured by the top 5 banks' share of the total assets in 1999. Thai land's top 5 commercial bankers in Bangkok controlled 75 percent of the total assets in financial community.

Second, the small number of critical actors in the financial sector made it easy for banks to coordinate their behavior. The Thai Bankers Association (TBA) was the most powerful interest organization in Thailand. It held regular meetings with the BOT and the MOF to lobby for a hand in shaping financial and monetary legislation. For example, when the revered central banker Puey proposed his plan to license new regional banks which were expected to counterbalance the Bangkok financiers, the TBA protested the plan and it was quickly shelved (LoGerfo and Montinola 2001: 79).

The ethnic Chinese's dominant economic power spilled over into other relations in Thai society. Along with their economic power, the majority of the ethnic Chinese business people acquired Thai citizenship and family names, and received a Thai education. By 1973, 63 percent of Chinese-dominated trade association members and 87 percent of their presidents held Thai citizenship. Conversely, a significant number of the family members of the indigenous bureaucratic elite were eager to enter the ranks of the Chinese-dominated business elite (Laothamatas 1994: 202). The absence of a Malaysian-style ethnic riot of 1969 was mainly due to the fact that most Chinese were Thai-ified and there was significant interconnection between two ethnic elite groups.

Thailand was a typical agro-exporter up to the early 1980s. But in the process of curing the banking crisis of 1984-86, the government executed a currency devaluation which transformed Thailand's competitive advantage as an industrial exporter. Financial conglomerate leaders were quick to switch over to exports. Manufactured products constituted 75 percent of exports in 1980s, far exceeding agricultural exports which were declining in the same period (World Bank 2003).

It should be noted that Japanese foreign direct investments (FDI) contributed more to the manufacturing exports than domestic industrialists did. FDI was ready to exit Thailand if profitability was low, although a comparative advantage of cheap labor kept the FDI in the country. Thai conglomerates focused less on the export economy and more on the growth of the domestic market caused by the multi-national firms; their new investments flew into property development, the service sector, and urban infrastructure development. Phongpaichit and Baker (2000: 18) described the Bangkok bankers in the economic boom as follows:

> Four or five major banks became such a large factor in the whole economy that their decisions on allocating credit were fundamental not only to their own profits but to the overall direction and health of the economy. These banks became the centers of sprawling business conglomerates. With the big banks often acting as their planners and consultants, these conglomerates dominated each area of business opportunity which opened up through this era – first agroprocessing, then import-substituting consumer industries, the basic process industries, and then urban services.

In contrast to powerful commercial bankers, the Thai politics experienced frequent regime changes back and forth: eight regime changes in the last three decades. Furthermore, the Thai party system featured a fragmented and fluid structure, which left the government with internally weak coalitions that were constantly subject to fission attracting the military's invasion into politics (Zhang 2005: 14). No groups or factions – civic or military – could maintain a prolonged or exclusive grip on power. Volatile and fragile, the Thai political system tended to encourage politicians to treat their offices as personal property to maximize their short-termed interests before their government collapsed or before a military coup occurred. This condition made the Thai state permeable to special interests, especially financial and industrial groups.

Figure 5-4 illustrates the backgrounds of members of the Assembly from 1933 to 1991 and Figure 5-5 shows the number of businessmen in the post-Sarit cabinet. Legislators with business backgrounds became more than bureaucrats-turned legislators during the Sarit cabinet (Feb. 1963 – Dec. 1963), whose market-oriented policies took root deeply in Thailand under U.S. pressure. The latter also demonstrates that the politicians from the business sector have been prevalent in the cabinet, especially in the Kukrit and Chatichai cabinets. These figures suggest that the weak and porous Thai state has been captured by private business interests.

Thai society and economy was dominated by Bangkok commercial bankers. Is this a good social base for CBI in Thailand? I argued in chapter 1 that financial capital favors monetary and financial stability, which is exactly what central bankers desire. The next subsection explores the answer.

The Bank of Thailand: From Autonomy To Dependence and Incapacity

The Thai National Banking Bureau, set up in 1939 with the status of a department attached to the Ministry of Finance, was the first organization to assume central banking activities in Thailand.[24] In fact, external challenges surrounding World War II led to the creation of the Bureau, which was designed to preserve Thai sovereignty during the war and to stabilize the country's economy after Japan's defeat. Japan, which occupied Thailand in 1941, asked the Thai government to establish a central bank with Japanese advisers and department heads, as they had in Korea by setting up the Bank of Chosen. The Prince Viwat, the financial advisor, succeeded in persuading the Japanese government that Thailand already had a central bank (i.e., the Bureau) and that a new institution was unnecessary. The Bureau quickly expanded its functions by establishing the Bank of Thailand (BOT) in 1942 (Doner and Unger 1993: 98). How did the BOT charter stipulate the CBI?

According to the BOT Act of 1942, which has not changed substantially, the Court of Director of the BOT is responsible for general directions, although the Minister of Finance is empowered to oversee the overall affairs of the BOT. The Minister has the following powers vis-à-vis the BOT:

1) to supervise general affairs of the BOT [Section 14];
2) to decide the question over which the Governor disagrees with a decision of the majority of the Directors [Section 17 and 29];
3) to recommend the Crown to appoint or remove the Governor and the deputy-Governor from their offices [Section 19 and 29-13];
4) to appoint the manager of the "Financial Institutions Development Fund," which is for financial restructuring [Section 29-3 and -11]; and
5) to appoint the President of the Audit Council [Section 37] and to get an audit report by the Auditors of the BOT [Section 29-23][25]

Legally, the MOF could hold the central bankers on a tight leash. The BOT, however, enjoyed high status as a result of its having deterred Japanese domination and maintained its own professional integrity during the war. During the 1950s and 1960s, the

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[24] Bank of Thailand (BOT) website (http://www.bot.or.th/bothomepage/index/index_e.asp). Accessed on Sept. 8, 2005.

[25] BOT's website (http://www.bot.or.th/bothomepage/index/index_e.asp). Accessed on Sept. 1, 2005.

Sarit government appointed Dr. Puey Ungphakorn as the governor of the BOT, and he was a revered figure among technocrats and academics. He extended a spirit of integrity and performance; the BOT was considered to be only institution that was not corrupt in the eyes of Thai people. This reputation gave it considerable moral authority and prestige, allowing it to "enjoy *de facto* autonomy, overriding its *de jure* subservience to the finance minister" (Siamwalla 1997: 12).

Let me introduce the BOT governors to examine their turnover rates, a proxy of the CBI. Table 5-2 displays the central bankers of Bangkok. The table shows a medium level of turnover for the BOT governorship: there have been 20 governors over 63 years. The rate measured by the number of governors a year is 0.32 a year. Each chairmen served, on average, 3.15 years. In comparison, the Thai overall turnover rate is higher than Singapore's (0.15) but lower than the Korean one (0.4).

Table 5-3 breaks down the post-Puey BOT governorship from the 1960s up to the present. The central bankers at Singapore and Taiwan enjoyed low turnover rates, while the BOT governors had higher turnover rates especially in the 1990s. Thai central bankers' turnover rates approached Korean counterparts in the 1990s. This disaggregated data suggests that the BOT was becoming more dependent. Why did the central bankers at Bangkok lose their once-established CBI? Let's examine the BOT's relationships with the MOF, politicians, and financial community in the 1990s as well as the BOT's internal organization.

First, conflicts in the inter-agency alliance that the central bankers previously benefited from led to the decline of the BOT's authority. In a democratic era, the macroeconomic technocrats lost their corporate sprit previously imbued with financial and monetary conservatism. In the 1990s, the BOT and the MOF competed with each other to achieve capital account liberalization. This inter-agency competition prevented both parties from sharing information about the risky and fraudulent operations of private financiers. The central bankers tried to mobilize social support in their conflicts with the MOF and therefore became more receptive to private bankers (Zhang 2005: 13). For example, central bankers proposed in 1992 the Bangkok International Banking Facility (BIBF), an offshore banking facility that opened in the next year. The BOT granted BIBF licenses to 47 banks: all fifteen of the domestic commercial banks were allowed to run their businesses at the BIBF (LoGerfo and Montinola 2001: 68). The offshore facilities were expected to intermediate "out-out" transactions, but huge amounts of money flowed into the mainland. The BIBF loan was about $11 billion in 1994; they quadrupled to about $43 billion in 1996 (LoGerfo and Montinola 2001: 69). Much of the fund was short-term in maturation and channeled into the property and real estate sector sponsored by big commercial bankers in Bangkok. In contrast to the Singaporean MAS that kept a close eye on global finance coming in and going out of the entrepôt-state, the BOT did nothing to regulate the huge flows of footloose hot money. In a way, the BIBF, a cause of the 1997 debacle, was the product of unfriendly and uncoordinated inter-agency problems.

Second, the inter-agency rivalry also encouraged politicians to infringe upon the authority of the BOT. During the 1960s and the 1970s, the MOF acted as a buffer between the monetary authorities and politicians, separating the BOT from distributive pressures from the government. With the protective buffer gone, politicians and special interests broke into the central banking system to gain access to distributive benefits for their constituents (Zhang 2005: 13). The Nukul commission investigated the causes of the 1997 debacle and reported that "in [the] recent past, top BOT officials were inclined toward political interests" (Haggard 2000: 25).

Third, the BOT was a close ally of private financiers in the 1960s and 1970s during which time the Bangkok bankers benefited from agricultural processing and food exports. As the Thai government liberalized capital accounts and devalued foreign exchange from the mid-1980s and especially 1990s, financial moguls clashed with central bankers over entry barrier deregulation, regulatory reform, and exchange rate realignments. The BOT lost its leadership of the financial community (Zhang 2005: 12). In the mid-1980s, a BOT official lamented as follows:

> We could order a bank to improve on any shadowy operations; but if it refuses, there is nothing much we could do apart form imposing nominal fines…The [present] law doesn't allow us to remove unqualified bank directors or senior executives.(Far Eastern Economic Review July 18, 1985: 82-3)

Fourth, the BOT governorship collapsed from within. After the revered governor Puey gained power, organizational authority was highly concentrated in the governor who could defend against political threats. The governor's power and autonomy worked as far as the gap of authority remained between top and lower officials. However, as BOT-sponsored graduates who earned Ph.Ds in the U.S. returned to become the mid-level managers, the governor was now considered only "one among equals." The factional fighting among the Ph.D economists-turned central bank officials eroded the coordinated teamwork of the BOT (Siamwalla 1997: 12). Furthermore, there was a "technocrat flight" to the private sector in the 1990s when Bangkok financial firms offered higher salaries to senior BOT and MOF officers. Private firms needed their expertise and personal connections to monetary and financial authorities. These inner conflicts and technocratic flights undermined the BOT's authority and credibility in the eyes of private business as well as Thai citizens.

Let me examine the BOT's performance in terms of maintaining price stability and a prudential financial system. Figure 5-6 illustrates the inflation rates from 1961 to 2001 comparing Thailand and Singapore. The inflation rates were 1.47 in the 1960s, 8.93 in the 1970s, 4.49 in the 1980s, and 3.89 in the 1990s for Thailand; the rates were 1.34, 6.3, 2.79, and 1.28 for Singapore, respectively. The overall averages are 4.7 percent for Thailand and 2.92 for Singapore. Thai inflation rates are comparable to ones in Germany, Switzerland, and the U.S that register high CBI: they averaged 3.65 in the same period. The BOT has been very successful in maintaining price stability.

Were the central bankers at Bangkok successful in keeping a prudential financial system, the other policy area? Unfortunately, the BOT did not keep pre-crisis nonperforming loan (NPL) data in an "official" sense. A data archivist (email interview, Sept. 7, 2006) at the BOT told me, "I'm sorry that we've no data before July 2000 because we started collecting the NPL data after the financial crisis occurred in Thailand." Delhaise (1998: 82) explained the lack of data as follows:

> Truthfulness in financial accounting was, and still is, pretty limited in both countries [Malaysia and Thai], but at least the central bank in Malaysia came public with the level of NPLs in the books of its charges, while little was admitted in Thailand. In both countries, individual banks were

> allowed to camouflage their non-performing assets and to rehabilitate themselves over the years.

There is a proxy indicator that is an equivalent to the NPL data. Figure 5-7 shows nonguaranteed private debt as a percentage of total external debts in Thailand and Malaysia. The Thai private sector borrowed a lot of debts in the first half of the 1970s, far exceeding the level that they could endure, although the rates reduced to around 20 percent in early 1980. As the Thai government put into practice capital account liberalization in the late 1980s and early 1990s, the rates skyrocketed. To make matters worse, the BOT propositioned the government to build an offshore financial center, the BIBF, and the rates skyrocketed again in 1993. Speculative short-term foreign capital showered into Thailand without any prudential filtering system, which the BOT lacked. Malaysia followed the same path. Non-guaranteed debt in both countries far exceeded the average of the World Bank-defined middle income countries.

There is another proxy indicator that reflects the quality of financial supervision. As Table 5-4 shows, I selected 10 survey questions asking about the number and the authority of the supervisors, the disclosure of risk management and credit rating, and the protection of deposits. I assigned 0 or 1 point and summed each point up to make an index. The data that I used was Banking Regulation and Supervision Database surveyed in 1999 by the World Bank. My index measurement is somewhat arbitrary, but it shows a rough picture of banking supervision in 5 countries that my study covers. The ranking reflects who survived the 1997 debacle and who faltered. The ranking order is Taiwan – Singapore – Malaysia – Korea – Thailand. The BOT and banking supervisors simply did not want to regulate and supervise their financial constituents.

It is a stark contrast with the BOT which was successful in keeping inflation low while it was poor at prudential regulation and supervision. What explains the gap between Thai central bankers' macroeconomic (i.e., price stability) strength and their microeconomic (financial prudence) weakness? Doner and Laothamatas (1994: 445), and LoGerfo and Montinola (2001: 75) pointed out exactly why the inconsistency occurred:

> Thai government has been more successful in macroeconomic stabilization than in trade and sectoral reforms, and this was due to an

> implicit bargain between state officials, politicians, and private sector actors.
>
> Thai officials often had the capacity to promote macroeconomic stability because it was a public good desired by the financial industry. But they were weak in the area of financial sector supervision, where gains to financial actors were particularistic.

Commercial Bankers, mainly constituted by Thai-Chinese families, were skillful and smart in exploiting the Thai state to regulate the public goods, monetary stability, within their desired limits but they resisted the state's supervisory intervention into their particularistic sectoral interests. This suggests that the financiers were powerful in Thai society, especially after the capital account liberalization during the 1990s.

The BOT's interest policy also reflects private financiers' skillfulness. Table 5-5 shows four Asian countries' interest spread (i.e., difference between lending rate and deposit rate) from 1977 to 2001. The more interest spread commercial bankers enjoyed, the more profit they gained. The Bangkok commercial bankers gained more than the other three countries; the spread was 0.54 for Korea, 3.06 for Singapore, 3.30 for Thailand, and 2.26 for Malaysia. Commercial bankers left the BOT untouched so the central bankers could do what they are good at, while denying the central bankers' any supervisory intervention into the financial community that they controlled. The BOT was not trapped by industrial financing, mainly due to the fact that Thai government usually limited itself to the role of macroeconomic manager, rather than delving into making specific industrial policies, as was the case with Japan and Korea. In fact, it was not necessary for the BOT to do so, since private oligarchic financiers as "cores of large conglomerates of nonfinancial concerns"(LoGerfo and Montinola 2001: 76) actually planned and operated the economic projects. Bangkok bankers approach what Rudolf Hilferding described as "finance capital" in the sense that "the magnate of capital increasingly concentrates his control over the whole national capital by means of his domination of bank capital" (Hilferding 1910[1981]: 225).

In chapter one, I proposed that politicians' coalition with commercial banks, farmers, and SMEs contributes to central bankers' independent authority. The BOT's uneven capacities over the two policy areas (i.e., inflation and financial stability) look inconsistent with the proposition. Two explanations shed light on this inconsistency. First, my hypothesis brings up an effect on CBI that the inclusion of heterogeneous sectors might have, which were found in Thai during 1970s when the BOT was still *de facto* autonomous from the MOF and bankers. In fact, central bankers were skillful in taking advantage various social groups mobilized in the mid-1970, aiming at enhancing the BOT's status vis-à-vis oligarchic financiers (LoGerfo and Montinola 2001: 82-3).

> Students, farmers, factions of military and industrialists not affiliated with bank groups supported monetary officials' move to weaken the oligarchic power of bank groups in the 1970s… Students, influenced by Marxism, protested against the power of capitalism, most clearly embodied in the banking community… Monetary officials were also supported by farmers in their bid to induce competition in the financial sector… Many farmers lost their land due to foreclosure on loans. After the 1973 revolution, farmers formed an organization, the Peasants Federation of Thailand… By the mid-1990s, the issue of market concentration in the financial industry was no longer a salient political issue… due to the economic boom that began in 1987. Students were busy taking advantage of the new job opportunities created… Non-bank affiliated industrialists… scrambled for the opportunities opened up.

When the loose distributional coalition broke down, there were no allies for central bankers to mobilize for their autonomous authority in the 1980s, when the CBI started to deteriorate.

Second, one might think about whether financiers made a "coalition" with the government. In the cases of Taiwan, Singapore, Korea, and Malaysia, government intervened in the economy and society, and selected different social groups as their social bases. The Asian crisis of 1997 showed that Taiwan and Singapore benefited from "virtues of commission" while Korea and Malaysia committed "sins of commission."

In Thailand, the government was friendly with commercial bankers, but their relationship was different from those in the other four countries mentioned above. Thai bureaucratic autonomy was poor, the governments were ever changing and fluid due to frequent cycles of military coup – democratic restoration – another coup. State power was fractionalized. Thus the state did not make coalitions with bankers from a position of strength. Bankers just infiltrated the state, holding it on a tight leash. One might call it "capture," rather than "coalition."

If there is what one might call a "coalition" between the government and Bangkok financiers, then the Thailand-born Asian catastrophe of 1997 suggests an effect of "finance capital" on CBI – that is, the danger from powerful financiers when they are not counterbalanced by any significant social groups and the governmental regulatory authority.

III. Malaysia: Politics of Ethnic Diversity and Partial Central Banking System

Politics in Multiracial Society: the UMNO and Bumiputera Industrialists

During the late 18th and 19th centuries, Great Britain established colonies and protectorates in what is now current day Malaysia; Japan occupied the area from 1942 to 1945. In 1948, the British-ruled territories on the Malay Peninsula formed the Federation of Malaya, which became independent in 1957. Malaysia straddles the Malay Peninsula – from the border of Thailand to Singapore, and the northwestern part of the island, Borneo. Its more than eighteen million people consist of three main ethnic groups: indigenous *bumiputeras* (sons of the soil) most of whom are ethnic Malays (accounting for about 48 percent of the population); and sizeable immigrant communities of Chinese (36 percent) and Indians (9 percent) (CIA 2005; Bowie 1994: 168).

Malays, descendants of migrants from Central Asia, are mostly concentrated in rural areas with a small portion residing in urban areas. The Chinese came as traders and tine miners in the 19th century, and their descendants are most numerous in the towns and cities where they dominate locally owned commerce and small scale industry. Indians were "imported" from South India by British plantation businesses to work on sprawling estates during the rubber boom of the turn of the century (Yap 2001: 61-2).

Nation-building in Malaysia in 1957 was made possible by the "Bargain of 1957," an "elite settlement" (Burton and Higley 1987) between majority Malays and minorities, which was codified in the Constitution. Elites from various ethnic groups agreed that Malays should dominate government. In return, the immigrant Chinese and Indian communities were granted full citizenship and protection from ethnically motivated official interference in their economic and cultural affairs. The compromise was contingent on each ethnic group respecting the boundaries that had been established. Those ethnic groups coexisted peacefully, but with suspicion and fear – a potential source of political unrest (Yap 2001: 61).

Three parties reflected Malaysia's ethnic diversity: the United Malays National Organization (UMNO) represented the majority of Malays while the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC) represented Chinese and Indians, respectively. The UMNO has been the dominant party in the two coalitions, the Alliance (1957-74) and then National Front (Barisan Nasional) that formed all governments since 1957.[26]

In the 1960s, inter-ethnic relations worsened. Despite continued growth, the disparities in unemployment rates and income increased between the wealthy urban Chinese and the poor Malays. "On 13 May 1969, race riots broke out in Kuala Lumpur in the aftermath of a general election where Chinese and opposition parties appeared to have made significant electoral gains at the expense of the Malay-dominated governing coalition" (Bowie 1994: 170). Armed Malays attacked and looted Chinese shops and houses. "Severe rioting, looting, and arson continued for two days… Property damage left 6,000 people homeless and social calm was completely restored only after two months" (Yap 2001: 62).

The 1969 riot was a historical event that dominated the Malaysian path of industrialization. The UMNO leadership learned from the riot that it was a political imperative to "cure" the disjunction of ethnic and economic power. They introduced a "new regime involving extensive state regulation of the private sector with the explicit objective of stimulating Malay economic participation" (Bowie 1994: 170-1). The 1969 riot contributed to the National Economic Policy (NEP) of 1971. It aimed to get rid of poverty, restructure society, and eliminate the identification of race with economic position.

The policy thus aimed to create *Bumiputera* (i.e., sons of the soil) entrepreneurs. The UMNO government helped Malays launch their business by offering cheap policy credits, and inculcated skills, expertise, and "capitalist spirit" to the indigenous businessmen to compete with non-*Bumiputeras* (Bowie 1994: 171). In 1975, the UMNO passed Industrial Coordination Act stipulating that any firm employ Malays more than 30 percent of total workforce. If a firm did not respect the Act, it will be denied any benefit from government such as tax relief, policy loans, and protection from imports (Yap 2001: 63). This measure targeted Chinese SME businesses, since they often use traditional family-based employment and ownership practices which effectively precluded Malay participation (Bowie 1994: 173).

Furthermore, Malay government established SOEs to accumulate economic assets in its hands and support *Bumiputera* entrepreneurship. For instance, the National Corporation (Pernas), the Naional Equity Corporation, and the State Development Corporations were SOEs that aimed to buy corporate shares of private firms and sell them to Malays in cheap prices. Other SOEs such as the Council of Trust for the Indigenous People and Bank *Bumiputera* provided a great amount of preferential policy loans to promote Malay entrepreneurship (Yap 2001: 64). Figure 5-8 shows the annual increase of the number of public enterprises from 1960 to 1992, demonstrating how the ethnicity-motivated state created the big bourgeoisie from above. The Malay government emphasized the manufacturing and service sector more than extractive businesses and transport.

Malaysian economic growth resembles the Korean path in that the two governments made serious efforts to foster big business by extending state-generated benefits to their economic coalition partners, *Bumiputeras* and *chaebols*. The UMNO government adopted an industrial deepening strategy, based on the capital-intensive heavy chemical sector in the 1980s. Dr. Mahathir Mohamad, prime minister, explicitly pointed to the Korean "economic miracle" as an exemplar case of growth in developing countries. Bowie (1994: 176) describes his strategy as follows:

> With high regard for the capabilities of state-led enterprises and suspicion of private sector industrial abilities, Mahathir embraced the South Korean import-substituting, export-promoting 'model.' South Korea appealed perhaps not simply because of its industrial record but also because it was

[26] The Barisan Nasional was initiated by from British conditions for the granting of independence. One of the conditions was the demand that the new government be truly representative of all communities.

> the only NIC whose people were not ethnically Chinese… Under pressure from… the Malay community to more aggressively pursue NEP goals using direct state action, Mahathir and the UMNO leadership found in the heavy industries policy an attractive vehicle by which to hasten the redistribution of economic power as envisioned in the NEP.

The targets of the industrial deepening included a project for a national car (Proton Saga), motorcycle engine, iron and steel mills, cement, and oil-refining and petrochemical project. A public sector agency – the Heavy Industries Corporation of Malaysia (HICOM) – was established in 1981 to lead the grand national project. The HICOM was chartered to plan, identify, initiate, invest, implement, and manage projects in the field of heavy industries. “Apart from enormous injections of public funds, the targeted industries were heavily protected through tariff and import restrictions and licensing requirements. For instance, the effective rate of protection for the iron and steel industry rose from 28 percent in 1969 to 188 percent in 1987” (Kanapathy 2000: 3).

The capital-intensive industrialization proved to be economically inefficient. At the end of 1988, federal government liabilities stood at US$ 2.2 billion, of which two-thirds took the form of contingent liabilities stemming from government–backed foreign loans. 37 percent of the total public sector debt (US$ 16.7 billion) was attributable to the public enterprise loans (Bowie 1994: 178). Gomez and Jomo (Gomez and Jomo 1997: 49) describes that the industrial deepening projects favored government-linked big bourgeoisies:

> Since the 1980s, government policies to assist Malays have tended to favor larger business interests rather than smaller companies. Larger, politically well-connected enterprises have enjoyed better access to government-created rents as business size and political influence have interacted as part of the new Malay idiom of power in contemporary Malaysia. In addition, commercial banks have also been more inclined to provide credit to large establishments.

Figure 5-9 illustrates the amount of credit extended by the banking sector measured by a percent of GDP from 1981 to 2001. Roughly speaking, Malaysia had two peaks of private credit by the banking sector, one peak in the 1980s and the other in the late 1990s. The first peak represents the government’s rush to capital-intensive industrialization by HICOM in the 1980s, while the second peak reflects the Malay industrial and financial firms' rush to the 1997 debacle. In contrast, a relatively smooth and level line for Singapore reflects that the Singaporean financial authorities kept the banking sector from overextending credit to businesses. In the case of Thailand, commercial bankers in Bangkok did not extend as much credit as their Malay counterparts did in the 1980, which reflects that Thailand did not experienced capital-intensive industrial deepening in the same period. But, as the Thai government liberalized capital accounts and built the offshore banking facilities in the early 1990s, the financial sector was overheated, heading for the Asian crisis of 1997.

How did the Malay government mobilize the financial resources for its industrial deepening project? The UMNO government simply captured the financial sector and confiscated the resources. In 1970, the Malay share of ownership in banking and insurance was merely 3.3 percent while the Chinese held 24.3, Indians 0.6, and foreign financiers 52.2. In 1986, however, "ownership or management control of banking services by *Bumiputeras* and government agencies had increased to between 60 and 70 percent" (Gomez and Jomo 1997: 60).

The story of the currently largest bank reveals the situation. Malayan Banking, the largest bank in terms of assets, was originally established by the Chinese tycoon, Koo Teck Tuat. In 1966, however, after rumors that he took bank funds for his own private enterprises, there was a massive run on the Banking. Next year, the Malay central bankers intervened to restructure the Malayan Banking, transferring the ownership to a government-owned bank.

Facing inefficient overinvestments during industrial deepening, the UMNO government launched economic liberalization in the late 1980s, as other developing countries did. Did the privatization package lower the political barrier for the non-Malay firms to operate in a "rational" market without the state's racial discrimination?

Liberalization has been politically feasible because the principal beneficiaries are foreigners and Malay business elites with symbiotic ties to the UMNO. The losers in the economic liberalization have been the Chinese business community. Small and medium scale Chinese firms that comprise the largest segment of domestically owned business have been, for the most part, excluded from the benefits of liberalization because of ethnic preferences. Because the Chinese tend to focus on retailing, services, and real estate and construction, they have not benefited from export-oriented industrialization with foreign partnerships with the manufacturing sector (Gomez and Jomo 1997: 66-66-71). In addition, foreign investors prefer to choose Malay partners in order to smooth investment approvals and ensure a sympathetic regulatory ear in positions of power.

Although the MCA and MIC were constituent parties of the Malay coalition government, they chronically suffered from intra-party factionalism. The rifts within each party cost both parties electoral support from key constituencies, which in turn reduced their ability to correct the racial bias of the UMNO. The non-Malay political elites have been marginalized as the balance of both political and economic power rests with the Malay elite. In response, minority businesspeople try to get personal, not institutional, access to the UMNO to obtain profitable partnerships in privatized government operations and infrastructure projects.

Economic growth itself was a political project in the sense that the UMNO government pursued its political survival in a racially diversified society by pouring national wealth to the *bumiputera* class. In this situation, central bankers usually faced political pressure to mobilize and distribute financial resources in a racially biased way, which contributed to less independence. As such, I expect that Malaysian central bankers are as dependent on the government as the central bankers in Korea.

Financial System: Singaporean Legacy and Partial Central Banking System

The Bank Negara Malaysia (BNM), the Malaysian central bank, was established in January of 1959, two years after independence, under the Central Bank of Malaysia Ordinance of 1958. The BNM charter shows that the bank did not enjoy the full autonomy from the UMNO government, especially the MOF. First, the MOF has influential power with regard to appointing the BNM leadership. The governor is appointed by the monarch (*Yang di-Pertuan Agong*) and the Deputy Governors by the Minister of Finance [Article 9, Section 1]. Since the monarch is a merely symbolic entity in Malaysia, the central bank leaders have to get the Minister's approval in order to act as members of any government committee dealing with currency, banking, and financial matters [Article 9, Section 3].

Second, the government can influence the central bankers' financial businesses. For instance, the BNM needs the finance minister's approval in order to: 1) issue securities in its own name [Article 30, Section 1]; 2) acquire, hold, and sell shares of any corporation and government [Article 30, Section 1-j and 1-o] ; and 3) grant loans to financial institutions [Article 34A, Section 1].

Third, when a disagreement happens between the BNM and the MOF, the Minister has the legal authority to issue directives to the BNM Board and the central bankers should observe the directive [Article 34, Section 2]. If the Board disagrees with it, the House of Representative jumps into the case as a judge [Article 34, Section 3]. Given that the UMNO has dominated the parliament since independence, the House is more likely to favor the MOF vis-à-vis the central bankers.

Fourth, the legal codes of the charter make it possible for the central bankers to provide preferential financial policies to the UMNO government's core constituencies. For instance, the BNM may make advances to farmers [Article 30, Section 1-ff], who are more likely to be Malays than Chinese. By establishing the Special Investment Fund, the central bankers finance specific projects of public authorities and corporations [Article 30, Section 1-fff and 1-ffff]. Those government-linked corporations have been an economic engine for Malaysia to push racially biased industrialization up to the present day. Furthermore, the central bank may establish a *Syariah* Advisory Council that is authorized to manage Islamic financial activities based on Islamic law [Article 30, Section 1 and 2]. It is the Minister of Finance who appoints the members of the Council.

Do the turnover rates of the BNM governorship reflect the central bankers' legal dependence on the MOF and the government? Table 5-6 lists the BNM governors and their terms of office. There have been 7 governors in the past 46 years. The turnover rate measured by the number of governors a year is 0.152. The governors served, on average, 6.57 years. In comparison, the rate is as low as the MAS of Singapore with 0.147 turnover rate and 6.8 average years of service.

Why is the turnover rate lower than expected, given the UMNO government's ethnically biased "big push" approach to Korean-style industrialization, and the MOF's legal influence over the Malaysian central bankers?

It should be noted that the Malaysian government delegated its ultimate financial responsibility to the Singaporean central bankers, not to the BNM. This "foreign delegation" of central banking operations originated during the British colonial era. Historically, Malaya's financial system was an offshoot of the Straits Settlements, and Singapore, the administrative center, remained the center of the financial system on the Malay Peninsula. The changing regulation of money in Singapore determined the situation in Malaya. Almost all the institutions for managing the financial resources were physically based in Singapore, from the banks' own system to the gradual assumption of governmental responsibility for money. The Currency Board of Singapore issued its notes from 1899, which were circulated in the rest of Malaya and in Borneo. After 1938, the peninsula of Malaya was formally incorporated into the currency area overseen by the Board of Singapore, followed in 1950 by Brunei, Sarawak, and North Borneo. These territories were incorporated to Malaysia during the state building process, but remained controlled by Singapore in financial and monetary terms (Hamilton-Hart 2002: 107). Malaysia's foreign devolution of central banking responsibility to Singapore continued even after its independence from the U.K. in 1957. The government left currency issue to the Currency Board in Singapore until 1967. Fixed exchange rates and exchangeability were on par with the Singapore currency until the mid-1970s.

The central bank never made much use of interest rate controls or credit directives to support industrial policy as Korea did. The UMNO government's most interventionist financial policies did not involve the central bankers (Hamilton-Hart 2002: 119-122). The government allowed central bankers to do their own work. Figure 5-10 shows annual inflation changes in Malaysia and Singapore, demonstrating that monetary values in both countries have moved lock-in-step. Their performance was spectacular. The MAS and BNM were successful in keeping monetary stability. The average is 2.91 percent and 3.38 over the period.

The Singaporean legacy led the government to respect the central bankers' responsibility over monetary stability. Thus, a counterfactual argument is possible that if there had not been such foreign delegation and Singaporean influence, the turnover rate might have been higher.

How did the UMNO government mobilize financial resources to pour into state-led economic expansion in favor of indigenous industrialists and state-owned enterprises (SOEs) while allowing central bankers to work independently? The financial vehicle was government-owned special banks. Government ownership in the banking sector began with the establishment of Bank *Bumiputera* in 1966 and the partial takeover of Malayan Banking (so-called Maybank) in 1967. These two banks subsequently became the largest in Malaysia and served as the financial engines for expansionist economic growth. Although the BNM was responsible for supervising all of the financial institutions in Malaysia, it lacked the political will and skills to oversee special banks that the UMNO government cherished for its developmental plan.

The Bank of *Bumiputera* serves as an example of the BNM's incapacity. In 1977, the Bank established *Bumiputera* Malaysia Finance (BMF) as a subsidiary in an effort to mobilize financial resources for fostering *Bumiputera* industrialists. The BMF was involved in banking fraud and corruption in 1979 and its huge financial losses were absorbed by its parent bank, which in turn was rescued by the state oil company. When the scandal broke out, the central bankers folded their arms and did not investigate the many irregularities in the transfer of funds from Bank *Bumipuetra* to BMF. That was because Razaleigh Hamzah, the Minister of Finance, had been the chairman of Bank *Bumiputera* before he entered the government. Since he was an important insider of the UMNO government, the central bankers stayed clear of the scandal (Hamilton-Hart: 2002: 120-1).

In fact, the BNM was subject to informal political pressures, especially in the 1980s when the government pushed capital-intensive industrial deepening. For instance, the third governor was forced to resign, reportedly because of a disagreement with the Finance Minister Daim Zainuddin. Daim was the most prominent of the *Bumiputera* businessmen who made enormous fortunes through close involvement with the ruling political party. He removed the powerful Capital Issues Committee from the BNM's control. The committee was responsible for overseeing new issues on the stock exchange and thus played a crucial role in UMNO government's privatization policy and the redistribution of wealth associated with the NEP.

The Malaysian case illustrates a "partial central banking system" where the central bankers provide relatively good performance in the traditional area of monetary stability but poor capacity in the financial regulation and supervision, especially in the financial liberalization era since the 1980s. The monetary dependence on, and synchronization with the Singaporean financial system prevented the UMNO government from intervening in the central bankers' authority over monetary stability. But the central bankers did not "intervene" into the highly politicized area of the special banking sector, even if the area was their responsibility. If they had dared to regulate and supervise the area, the government would likely have forced them to retire from their governorship.

IV. Conclusion

So far I have examined the extent to which my arguments on Korea and Taiwan apply to three Southeast countries, Singapore, Malaysia, and Thailand. Each country was different in its sensitivity to macroeconomic instability, mainly due to the political leadership's choice of economic growth strategy and developmental partners. In other words, each central banking system was put in the larger context of a developmental design that affects the central bankers' autonomy from the government, and thus their performance with regards to monetary and financial policies.

Singaporean MAS was the most autonomous of all three of the Southeast Asian countries. Expelled from Malaysia, the PAP government attracted foreign capital to the entrepôt state for its political and economic survival, which led the Singaporean state to support the MAS-MOF's independence with a wide range of financial and monetary authority. Although the MAS was not very independent from the MOF, the actual autonomy the MAS enjoyed was considerable given that the financial officialdom fully supported the Singaporean central bankers.

In the case of Malaysia, the UMNO government heavily depended on indigenous industrialists, *Bumiputeras*, after the riot of 1969. The government wanted to survive in a society that marked by a disjuncture between economic and ethnic power. It did so by promoting its developmental agent, the *Bumiputera*, while discriminating against ethnic Chinese. But the government's preference for the indigenous industrialists did not contribute to the central bankers' subordination to the government because the Kuala

Lumpur government delegated central banking authority to Singapore, which was characterized by autonomous and effective monetary management. But Malay central bankers stayed away from state-owned banks, such as Bank *Bumiputera*, which were critical of the government's expansionist growth strategy. Central bankers were independent and effective in the monetary issue area, although their financial regulation was poor since they "counter-delegated" their financial regulation authority to the government.

Commercial bankers in Bangkok suffered from the statist Phibun government, and then revived under the Sarit government, which launched a pro-market drive to destroy the predecessor government's power base, the government sector. The post-Sarit government's social base was Chinese commercial bankers who dominated agro-business financing, the foundation of national wealth of the country. Originally Thai central bankers were autonomous and respected from financial community, but after 1980s when the government liberalized the economy, especially the financial sector, the central bankers lost their autonomy due to conflicts with the MOF and commercial banks. Thai central bankers are similar to Malay counterparts in the sense that they maintained stable macroeconomy but were incapable of regulating and supervising the financial sector.

Chapter 6: Quantitative Analyses of Central Bank Independence in The Developing Countries in the 1980s

In this chapter, I employ statistical methods to analyze cross-national variance in central bank independence (CBI) in developing countries during the 1980s. In the first section, I restate my hypotheses introduced in chapter 1. In sections 2, 3, and 4, I operationalize relevant variables to test the hypotheses. In the fifth section, I test the hypotheses by using cross-sectional regressions and principal component analyses. The final section is a conclusion that summarizes my statistical analyses.

I. Hypotheses

As I already showed in chapter 1, two hypotheses are generated in terms of political coalition types and their effects on CBI.

Hypothesis 1: *If capital-intensive industry and/or organized labor have a strong presence in an economy, the country is less likely to have central bank independence.*

Hypothesis 2: *If the other groups (i.e., the financial sector, agriculture, and/or small and medium-sized enterprises) are dominant in an economy, the country is more likely to have central bank independence.*

II. Dependent Variables: Behavioral and Overall CBI

Typically, CBI refers to independence from the executive branch of government and the legislature and/or protection from "capture" by the commercial banks it regulates. The conceptual definition of CBI in this dissertation is the extent to which a central bank has discretion to set goals for monetary policies and choose tools (Maxfield 1997). There have been efforts to measure CBI, although researchers usually use decade-by-decade CBI indicators constructed by Cukierman, Webb, and Neyapti (1991) since their measurement is reliable and systematically constructed and the data coverage is wider than any others.

They devised indicators of three types: formal, behavioral, and overall indices of CBI. The formal index focuses on legal codes governing the appointment of the central bank governor, policy formation, and lending policy. Unfortunately the legal index does not represent the actual inflation-fighting authority of the central banks, especially in developing countries. A central bank may be formally independent but nevertheless unable to carry out effective anti-inflationary and prudential policies because it is not influential in the formulation and implementation of policies by other governmental agencies. Cukierman et al. (1991) and Maxfield (1994) found that the legal CBI is not correlated with policy outcomes (i.e., inflation rates) in developing countries.

The behavioral CBI index is based on the turnover rate of central bank governors. The idea is that if the political authorities frequently take the opportunity to choose a new governor, they will at least have the opportunity to pick those who will do their will. One might suspect that a low turnover rate does not necessarily imply a high level of CBI, however, because a relatively subservient governor may stay in office for a long time. But statistical analysis shows that a low turnover rate is highly correlated with the low inflation rate that central bankers set as their main goal (Cukierman et al. 1991). Furthermore, it is not easy to find any consistent indicator of CBI, other than the turnover rates, for large-N analysis. The index is measured by the average annual turnover rate of central bank governors from 1980 to 1989. To avoid confusion, I recoded such that:

$$\text{behavioral index of CBI} = 1 - \text{turnover rate}$$

The overall CBI indicator is an effort to combine formal – legal independence and turnover by a weighting scheme to obtain an aggregate measure of CBI. Such weighting is somewhat arbitrary, but it reduces the arbitrariness by setting the weights equal to the coefficients of legal and behavioral indices from the regressions in which they are used to explain the variation in the logged inflation rates (Cukierman 1992: 433). Note that the behavioral component is given greater weight in constructing the overall CBI index since it is more representative of inflation-based CBI than the legal indicator. I use the behavioral and overall indexes of CBI as dependent variables in my statistical analyses.

In order to carry out the statistical analyses, I created a dataset on 36 developing countries in the 1980s.[27] The other developing countries and decades are not included in my analysis mainly due to missing data on the dependent and independent variables. Since Cukierman et. al. reported decade-by-decade CBI data, my independent variables are also decade average data (i.e., 1980-89), which means my statistical tests are basically cross-national analyses.

III. Independent Variables

Capital-Intensive Industry [HEAVY][28]

Capital-intensive industry is measured by heavy manufacturing sector comprising electronic, metal, and chemical industries as a percentage of the whole industry. The data were taken from the World Bank's *World Development Report* and I took the average of annual values from 1975 to 1989. I chose this time frame since a systemically collected cross-national dataset on the dependent variable, CBI, is available only for the 1980s. Furthermore, it may take time for the CBI variable to reflect changes of socio-economic variables like the HEAVY so I included the latter half of the 1970s for the HEAVY.

I expect countries with high levels of capital-intensive industry to be more likely to have low CBI, all things being equal. The reason is that central bankers' main goal is monetary and price stability, but capital-intensive industry as a holder of specific assets will derive more value from government-induced favorable price changes than holders of more liquid assets will. Furthermore, heavy industry in developing countries is usually a debtor that borrows the capital it needs and high inflation usually favors debtors over creditors. In this sense, capital-intensive industry is expected to have an intense preference for low CBI.

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27 Included in the dataset are Argentina, Brazil, Chile, Columbia, Egypt, Ethiopia, Ghana, Greece, Honduras, Hungary, India, Indonesia, Israel, Kenya, Korea, Malaysia, Mexico, Morocco, Nicaragua, Nigeria, Pakistan, Panama, Peru, Philippines, Poland, Portugal, Singapore, South Africa, Thailand, Turkey, Uganda, Uruguay, Venezuela, Zambia, and Zimbabwe.

28 HEAVY refers to the variable name that represents capital-intensive industry and will be used in regression models.

Organized Labor [UNION]

Organized labor is proxied by the number of union members as a percentage of the non-agricultural workforce. The data on organization rates were available from the World Bank's *World Development Report* and I took the average of annual data between 1975 and 1989.

My expectation is that the organized labor is negatively correlated to CBI but that the correlation is weak. The "weak" correlation comes from the fact that workers have conflicting positions with regard to the price stability that central bankers take as their main policy goal. As producers, they get benefits from nominal wage increases and price increases of the products that they produce, yet as consumers they prefer price stability.

The strength of organized labor's negative correlation with CBI is, however, mainly due to the fact that producers are more likely to organize to protect their benefits than consumers are, as collective action theory suggests (Olson 1965). In addition, the cost of tight monetary policy and austerity measures such as cuts in subsidies tend to be felt immediately, while their benefits from price stability are usually socially diffuse and temporally distant. Lastly, unionized workers are usually found in the capital-intensive sector and their material welfare often depends on the profitability of the sector, which suggests that they will have the same negative preference as the sector with regard to CBI.

Financial Sector [FINPWR]

The power of the financial sector is measured by the sum of the indices of universal banking, banking supervision, and party fragmentation weighted by M2/GDP. Let me briefly explain how each component relates to CBI.[29]

First, universal banking heightens the sectoral power of finance because universal banking means that there is no competitive divide among financial subsectors in their reaction to inflation. Moreover, it is for the sector to reach political consensus on all issues, as they already face unified regulations and markets. Thus, a financial sector with universal banking should express stronger anti-inflationary sentiment than the sector without. I coded 2 for "unrestricted," 1 for "permitted" or "restricted," and 0 for "prohibited" in each subsectors of securities, insurance, real estate, and ownership of non-financial firms.[30] The data on the 36 developing countries during the 1980s were taken from Barth, Caprio, and Levine's database (2001).

Second, although central bankers' main policy goal is price stability, some countries allow them to carry out an extra function of financial supervision, and others set up an independent agency for their supervision. Where the monetary authority restricts the allocation of credit or lending rates, individual commercial banks conflict with the central bank. Since commercial bankers tend to prefer unlimited freedom of their financial business, they may seek to limit the central bank's supervisory power. Conversely, when the central bank has no bank supervisory responsibilities, the financial sector has no incentive to oppose the central bank's autonomy. I coded 1 if the banking supervision is not under the central bank, 0.5 if it is shared by the central bank and other agencies, and 0 if it is solely the central bank's responsibility. The data is drawn from Barth, Nolle, Phumiwasana, and Yago's data (2002) and Neil Courtis (2001).

Third, as the fractionalization of the party system increases, local interests tied to particular parties or to even particular members' constituencies should see their particularistic goals better served by the legislative process. Given the financial sector's interest in a national issue (i.e., price stability) and claims to expertise, we can predict that where a country's party system is less fractionalized, financial opposition to inflation should be more effective. Conceptually, fractionalization is the probability that two legislators chosen at random from a national legislature belong to different parties. It is measured by one minus the Herfindahl concentration index. The data are available from Beck, Clarke, Keefer, and Walsh's database (2001).

Finally, the relative size of the financial sector is usually measured by M2 as a percentage of GDP (Snider 1996) since M2 represents the amount of financial assets

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[29] For theoretical discussion about universal banking, banking supervision, and party fragmentation, see Posen (1995).

[30] Posen constructed the index the sources of which are various national data. The index is either 1 or 0. It is 1 if banks are allowed to deal with at least two of securities, insurance, and commercial lending, and otherwise 0. But I differentiated them more in detail since Barth et al.'s database (2001) contains more diverse information about cross-national banking systems.

deposited in financial institutions and money markets.[31] The M2 reflects the economic power of the sector in an economy, while the aforementioned 3 variables (universal banking, bank supervision, and fragmentation of party system) represent political and organizational "filter" through which the economic power of the sector gains political influence. So, I combined those 4 variables to measure the power of the sector, as follows:

Power of the financial sector [FINPWR] = (universal banking + bank regulation – fractionalization) x M2/GDP.

I expect that the FINPWR is strongly and positively correlated with CBI since the financial sector is a creditor that is penalized by price instability. Central bankers assume a role of "the bank of banks."

Agriculture [AGRI]

Agriculture is measured by agricultural production as a percentage of GDP. I took the average of annual data (1975 – 1989) from the *World Development Indicator* (2003). I expect the agricultural sector is positively but weakly correlated with the dependent variable, CBI. An economy heavily drawing on agricultural production can be assumed to be less capital intense and less asset specific than one relying on industry for a large share of domestic products. In addition, agricultural production is usually unstable, mainly due to frequent changes of natural conditions (i.e., precipitation, duration of sunshine, and average annual temperature). Thus, farmers' gains from their business are often volatile and unpredictable, and they will suffer even more if the market is inflation-stricken.

But farmers have dual positions (i.e., consumer-cum-producer) and there are large cross-national variances within the sector, which means agricultural interests have a weak preference for price stability and CBI.

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[31] M1 is the sum of currency held by the public and checkable deposits. The broader aggregate M2 includes consumer time deposits at various financial institutions, money-market deposit accounts, and some other items. Still broader monetary aggregate M3 includes additional types of financial assets (Barro 2000).

Small and medium-sized enterprise [LIGHT]

Small and medium-sized firms (SMEs) are measured by light manufacturing sectors comprising food, beverage, tobacco, clothing, and textile industries as a percentage of all industries. The data were taken from the World Bank's *World Development Report* and I took the average of annual values from 1975 to 1989.

I expect that light industry, mainly consisting of SMEs, has a weak positive correlation with CBI. It is positive since, like agriculture, the sector is usually less capital intensive and less concentrated, compared to heavy industries. In addition, light industry tends to lose its weight as capital-intensive industry leads industrialization.

On the other hand, historically, the stage of light industrialization was often related to political liberalism, whereas military authoritarianism or Fascism stepped in during the industrial deepening eras in developing countries. Since capital accumulation of textile industrialization could be accomplished largely without industrial financing by the state, there was an elective affinity between the light industry, commercial banking, and the liberal regime (O'Donnell 1973; Kurth 1979). There may be a possibility that political liberalism, compared to authoritarianism or fascism, is a favorable condition for a government to delegate its financial authority to central bankers or not to intervene in the policy process of the central bank. But light industry's relationship with CBI will be weak since light manufacturers, as producers, may sometimes want to secure preferential credits and loose monetary policy for their business.

For our statistical analysis it should be noted that light and heavy industries are negatively correlated with each other for their shares of national production. This causes a multicollinearity problem, which will be addressed in the section of regression analyses and results.

IV. Controls

Government partisanship [PARTISAN]

Hibbs (1977) argue that rightist governments are likely to allow CBI since they tend to prefer low inflation rates at the expense of high unemployment. In contrast, leftist governments are against central bankers' independent authority since they prefer low unemployment in expense of high inflation. Based on data from Beck et al.'s *Database of*

Political Institutions (2001), I coded rightist government 1, leftist -1, and centrist 0. I expect a positive relationship between the partisanship and CBI.

Political Business Cycle [PBC]

Political business cycles suggest an opportunistic CBI theory that inflation rates fluctuate according to electoral cycle (Nordhaus 1975). Thus an election-motivated government will deny central bankers inflation-fighting authority and print more easy money to boost the economy as an election comes near. But, after the election, the winner will support CBI so as to lower the election-motivated high inflation. The variable is proxied by the difference between the highest and lowest logged inflation rates in each election cycle in the 1980s. The data were taken from *World Development Indicators* (2003), Beck et.al.'s *Database of Political Institutions* (2000), and Marshall and Jaggers' *Polity IV Project* (2002). I expect that the cycle is positively correlated to CBI.

'Tying successor's hands' theory [SUCCESSOR]

Boylan (1998) argued that outgoing authoritarians may seek to protect their interests by increasing the CBI that would otherwise be subject to the vicissitudes of the democratic process. To control the variable, I measured it by the frequency of changes from authoritarian/rightist governments to democratic/centrist/leftist governments in the 1980s, based on Beck et.al.'s *Database of Political Institutions* (2000). I expect that the control variable is positively correlated to CBI.

Government Financial Needs [GOVDEBT]

Since private creditors, domestic or international, regard CBI as a good indicator of financial credibility, governments may allow CBI in order to draw money from the creditors so they can fund their financial needs (Broz 1998; Maxfield 1997). The variable is measured by central government debt as an average percentage of GDP in the 1980s. Data were taken from *World Development Indicators* (2003).

International Economic Integration [INTLECO]

The more internationally integrated an economy is, the more likely it is that a government's need for finance will yield central bank independence, because CBI is taken as both a sign of governmental commitment to desirable economic policies and an opportunity for increased creditors' influence over government policy via a more independent central bank (Maxfield 1997). I measured various levels of global economic integration by import and export of goods and services as a percentage of GDP.

Macroeconomic instability [INFLA]

The stability of the price level is an important variable to be controlled since the macroeconomic conditions are certain to affect CBI. Statistical analyses, however, already showed that inflation rates are negatively correlated with the CBI: a low turnover rate is highly correlated with a low inflation rate that central bankers set as the main goal (Cukierman 1992). Thus, I devised an alternative indicator rather than using inflation rates to test the seemingly established argument.

Although inflation rates are central bankers' critical concerns, inflation rates may not be a constraint in the eyes of self-interest elected officials. This is because politicians will be concerned about the macroeconomic condition only if they feel it affects their political welfare. In other words, if they don't perceive that the inflation will affect their welfare, they will not respond to the rate. To measure how important the inflation rate is to the elected official, I use a proxy consisting of two components to represent the variable. The first component is based on an assumption that the government party's power to manage economic policy will be diminished by macroeconomic instability. So, for government elites, an inflation rate will be represented such that:

$$\text{Inflation 1} = [P_1 / (P_1 + P_2)] - [P_1 / (P_1 + P_2)] / r$$

where P_1 and P_2 are the shares of seats held by a government party and the largest opposition party, respectively, and r stands for annual inflation rates. Note that the governing politicians' ultimate goal is political survival, that is, winning political competition with the largest opposition party (P_2). So the first term, $[P_1 / (P_1 + P_2)]$, means governing politicians' power vis-à-vis their challenger, while the second term, $[P_1 / (P_1 + P_2)] / r$, represents their power adjusted by the inflation rate. The difference between the two terms is the political loss that incurs from macroeconomic instability from the perspective of governing politicians. Note that the inflation in an economic sense does not directly relate to a political loss. Rather, inflation is transformed to the political loss for governing politicians only when it affects government party's power vis-à-vis oppositions, which is what the equation suggests. The relevant data are available from Marshall and Jaggers' *Polity IV Project* (2002).

Another part of the political loss from inflation is related to the "tenure security" variable that varying inflation rates might affect. Governing politicians learn from the past political history by which they expect their political expectancy in the future. If inflation-related government changes were frequent in the past, government officials will be serious about the macroeconomic situation. Thus they will consider the political loss that inflation partially caused to in the past. It is proxied by the frequency of government/regime change weighted by inflation as follows:

$$\text{Inflation 2} = r\,|DA| + 0.5\,r\,|DD| + 0.5\,r\,|AA| + r\,|AD|$$

where r (i.e., logged inflation rates at the time of government/regime change) = 1 in the case of low inflation (0 to 10%), r = 2 in the case of Latin inflation (11 to 1000%), and r = 3 in the case of hyperinflation (more than 1000%).[32] Government/regime changes are categorized as democratic to authoritarian (DA), democratic to democratic (DD), authoritarian to authoritarian (AA), and authoritarian to democratic (AD) from the period of the 1960s to the 1980s. Different values of k (i.e., 1 or 0.5) are meant to make the political loss sensitive to inflation rates.[33]. I assume that DD and AA are less costly for governing elites than the other two, so I employ different weights, 1 and 0.5, respectively.

32 The classification of inflation rates is based on Charles S. Maier (1978: 43). I added different values of r and |DD| term to Clark's formula (1994).

33 There is a possibility that people rewards governing politicians for their managing inflation rate within low or moderate ranges (i.e., less than 10%) and thus the governing party pays off with macroeconomic stability. The nature of logarithm matches the situation. If inflation rate is less than 10, logged value is less than 1, decreasing political cost in the formula.

Note that "| |" stands for "the cardinality of." The above formula means that governing politicians will face tenure insecurity and thus high political disadvantage if their country features a high frequency of government change during periods of high inflation. I expect a negative relationship between macroeconomic instability and CBI since politicians will replace central bankers if they feel a high inflation rate is politically harmful to their welfare. The data is available from *Polity IV Project* (2002), and *World Development Indicators* (2003).

In summary, the regressions tested are a reduced-form specification of CBI as follows:

CBI = f [AGRI (+), FINPWR (+), UNION (-), LIGHT (+), HEAVY (-),
, PARTISAN (+), PBC (+), SUCCESSOR (+),
GOVDEBT (+), INTLECO (+), INFLA (-)]

V. Regression Analysis and Results

OLS Cross-Sectional Analysis

I carried out statistical tests of my hypotheses using OLS regressions, as Table 6-1 and 6-2 show. Note that UNION, LIGHT, and HEAVY are correlated with one another, causing a multicollinearity problem. Thus I included them one by one in each model.[34] Table 6-1 shows test results of regressing on behavioral index of CBI in developing countries during the 1980s.

The coefficients of AGRI are significantly positive in model 1 and 4, as I expected, although the variable is not significant in model 6. FINPWR is not significant in model 1, but it has positive coefficients at least at 0.05 level in model 2, 3, 4, and 6, which indicates that central bankers are more likely to have independent authority when the financial sector is highly developed and organized. LIGHT has a significantly positive coefficient in model 2, but not in model 6. HEAVY and UNION have negative signs as expected but neither are significant.

34 The other method to address the multicollinearity problem is principal components analysis that will be dealt in the next section.

COUNTER is a sum of AGRI, FINPWR, and LIGHT which are expected to countervail against capital-intensive industry (i.e., HEAVY). The coefficient of COUNTER in model 5 is significant and positive, which suggests that central banks are more likely to be independent when agriculture, the financial sector, and SMEs are dominant in economies. INFLA has the same sign as I expected and is significant in model 1, 4, and 5, suggesting that, if inflation is politically harmful to elected officials, they will replace the central bank governor, which reduced CBI. All control variables are poor in predicting cross-national variations of central bankers' independent authority.

Table 6-2 shows statistical results of regressing on overall index of CBI in developing countries during the 1980s. AGRI, UNION, LIGHT, and HEAVY have coefficient signs that I expected, although neither is statistically significant. Various models except model 1 show that the coefficients of FINPWR are significant and positive as I expected. The coefficient of COUNTER is positive and significant in model 5. INFLA has the same sign as I expected, and is consistently significant in all models. Control variables are still not good predictors of CBI since their standard errors are all larger than their coefficients.

In sum, Table 6-1 and 6-2 show that FINPWR and COUNTER survived the double tests of regressing on behavioral and overall index of CBI. FINPOWR and COUNTER variables support my hypothesis 2, while AGRI and LIGHT are not consistent predictors of varying degrees of CBI even if they have the coefficient signs that I expected. OLS regressions do not support my hypothesis 1 since UNION and HEAVY lack significance in a statistical sense. Hypothesis 3 does not obtain statistical support since the coefficients have the opposite signs from that I expected.

Principal Components Analysis: Capital-Intensive Industry, Labor and CBIs

According to Table 6-1 and 6-2, capital-intensive industries measured by heavy manufacturing sector do not support my hypothesis 1. It may be better to consider other capital-intensive businesses to capture the variable since the measurement (i.e., HEAVY) does not include, for example, mining, transport equipment, energy, oil, and non-metal processing industry, etc.

We need additional information about a country's production profile so we can see how much capital-intensive industries matter in an economy. An alternative measure of the production profile, for example, is the portion of national income spent on fixed capital, under the assumption that those societies that make intensive uses of capital, relative to other inputs, in the production process tend to plow a larger share of their earning back into capital formation than those that do not (Clark 1994). Thus, indicators that represent capital-intensive industry include: 1) unionization ratio; 2) size of the manufacturing sector; 3) fixed capital formation; 4) minimum of fixed capital formation; 5) maximum of fixed capital formation; and 6) heavy manufacturing.

The size of the manufacturing sector is measured by the production from the manufacturing as a percentage of the GDP. I took the average of annual production in the 1980s. Fixed capital formation is captured by the decade average of annual gross fixed capital formation in the 1980s. The minimum and maximum of the formation are the highest and lowest annual values of the variable. All data come from *World Development Indicators* (2003). The source of the ratio of unionized labor and heavy manufacturing are mentioned in the previous section.

But as Table 6-3 shows, most of the variables for the capital intensity are correlated with one another, which causes a multicollinearity problem (i.e., imprecise regression parameter estimates due to highly correlated independent variables). To address the problem, I used principal components analysis. It is a statistical technique that linearly transforms an original set of variables into a substantially smaller set of uncorrelated variables that represent most of the information in the original set of variables (Dunteman 1989). In other words, I used hypothetic scores produced through the technique that still parsimoniously preserve characteristics of the aforesaid six variables. I used the first principal component scores since the first component accounted for 51.8 percent of the variances of the six variables. The second and succeeding components accounted for considerably less variances ranging from 20 percent for the second component to 2 percent for the sixth component.

Table 6-4 shows coefficients of variables regressed on behavioral index of CBI in developing countries during the 1980s. CIIPC, referring to capital-intensive industry produced by the principal components technique, is consistently significant and has a negative sign as expected, which supports my hypothesis 1. FINPWR also survives various tests, showing a significantly positive sign as expected. INFLA has a significantly negative sign in model 3 and 4, but not in model 2.

CIIPC and FINPWR in Table 6-5 are less consistent determinants of overall CBI. The former is a significant independent variable in model 3 and 4 as we expected, although insignificant in model 1. The latter has significantly positive coefficients in model 1 and 2, but not significant in model 4. Again, INFLA has consistently negative coefficients, all of which are statistically significant.

Principal Components Analyses: Non-Capital-Intensive Sectors and CBIs

Table 6-1 and 6-2 show that the non-capital-intensive sector (i.e., COUNTER) is a statistically significant determinant as I expected. To confirm this, I executed a principal components analyses by using the first component scores (i.e., COUNTERPC) that linearly transformed agriculture, light industry, and the financial sector since I assumed that those sectors countervail against capital-intensive industry, contributing to central bankers' independent authority.

Table 6-6 and 6-7 show the results. I excluded HEAVY and CIIPC from regression tests to avoid the multicollinearity problem. COUNTERPC has positive coefficient signs that are significant, which suggests that a country is more likely to have an independent central bank in behavioral as well as overall terms when the production profile is dominated by those non-capital-intensive sectors. The results support my hypothesis 2.

VI. Financial Fragility, Supervisory Authority, and Social Interests

Although the statistical tests of developing countries confirms my two hypotheses, the Thailand and Malaysia cases pose a possibility that monetary and supervisory authority might be heterogeneous and different components of the CBI. Those two cases demonstrated that central bankers can be powerful and effective in the policy area of monetary stability, while they cannot be so in terms of financial supervision. Those two "inconsistent" countries are stark contrasts to "consistent" cases: Taiwan and Singapore represent strong macroeconomic stabilizers and financial supervisors while Korea stands for a weak macroeconomic stabilizer and financial supervisor.

I ask if sectoral preferences for central bankers' supervisory authority and financial fragility are the same as their preferences for the CBI that were already confirmed by statistical tests above. I used "Banking Regulation and Supervision Database" surveyed by Barth, Caprio, and Levine (2001). I test how sectoral interests affect central bankers' supervisory authority and financial fragility. Table 6-8 shows how I measured each variable covering 68 countries. Table 6-9 indicates correlation results.

As I expected, the correlation coefficient of a central bank supervisory power [CBSUPWR] is negative and significant with financial fragility [PRINFRAG]. If central bankers do not have supervisory power, the whole financial system will be not prudential, vulnerable to a financial crisis. The size of the agricultural sector [AGRI] in an economy is positively and significantly correlated with central bank supervision while negatively and significantly with financial fragility, which suggests that the agricultural sector's preference contributes to a prudential financial system.

Interestingly enough, the power of the financial sector [FINPWR] does not have a significant correlation either with supervisory authority or with fragility. In the previous regression tests, the sector has a strong supporter of CBI measured by turnover rates and legal CBI. What does this inconsistency mean? Although the variable is insignificant, it hints that private financiers support central bankers' independence from the government while they might not want their central bank to supervise their own operations. At least, their preference for the central bank's supervision is not as intense as for its macroeconomic management. As the Thailand and Malaysia cases indicate, the financial sector may want more freedom to run financial operations in a globalizing era, but they are reluctant to be supervised. Further research could help clarify this issue.

As I expected, the capital-intensive industrial sector [CIIFIXED] has a negative correlation coefficient with central bank supervisory independence, but a positive coefficient with financial fragility. This result confirms that big firms and big industrialists want their government to bring pressures to bear on central bankers. They want more cheap credits, a bête noire of conservative central bankers. The capital-intensive industrial sector has a consistent preference for low CBI and low supervision.

As for light industry or the SME sector [LIGHT], it is not a significant variable in affecting the central bank's prudential regulation, although its correlation coefficient is just what I expected. This suggests that the light industry has a weak preference intensity when it comes to supervision by central bankers.

Degrees of government's banking ownership [GOVTOWN] are not significantly correlated with the CBSUPWR and PRINFRAG variables. This stands in contrast to neoliberal economists' arguments that government's intervention by public enterprises tends to distort the efficient distribution of resources in a society, and thus that SOEs should withdraw from the market. The statistics show that this is not the case. One possible explanation is that a government's banking industry may counterbalance private banks' and NBFI's endless desire for risk-taking operations for profit, especially in a globalizing era. The state's presence in the banking sector might be a source of corruption and crony capitalism but, as one sees from the Taiwanese case, government-controlled financial intermediaries can protect the financial community from speculative banking operations since their aim is not to pursue profits, but instead to channel financial resources to targeted sectors of a society. This kind of banking operation may be inefficient in the eyes of neoliberal reformists.

Short-term debt [SHTRMDET] has no significant correlation with the CBSUPWR variable, although it has a positive correlation coefficient with financial fragility. The coefficient is significant at 0.01 level. This is quite understandable as one sees the dire impacts of short-term speculative capitals on the Thai economy in the 1990s.

The previous sections already showed that inflation [INFLA] has a consistently negative impact on central banker's independent authority [CBI]. Likewise, price instability [INFLA] has a consistently negative effect on the CBSUPWR variable. But, interestingly, it does not affect financial fragility, which hints that, technically speaking, monetary and financial policies are different from each other. It should be noted, however, that they are often closely related. James Barth et al. (2002) once explained how a policy failure in one area can spill over into another policy area.

> In case where the central bank has dual responsibility for banking supervision and monetary policy, it may pursue a too-loose monetary

> policy in order to avoid adverse effects on bank earnings and credit quality…. [On the contrary,] if the central bank is responsible for bank supervision and bank failure occurs, public perception of its credibility in conducting monetary policy could be adversely affected.

Lastly, the insurance scheme for savings [INSURE] has an unexpectedly negative correlation coefficient with central banker's supervisory power. It is significant at 0.05 level. Are prudential schemes provided by insurance programs incompatible with a central bank's supervisory efforts? Do the insured clients, once insured, have more incentive for "moral hazard" to commit themselves to risky behaviors that supervisory agencies aim to reduce?

From my perspective, two explanations are possible for the unexpected effects of the insurance system on the financial supervision. First, when a government sets up a public insurance scheme, it tends to provide the insurance agency with some supervisory functions, since the agency has to know information about insured member firms' risk management so that it can impose differentiated insurance premium rates to member banks. In this case, the central bank is not the single supervisor. Note that, as shown in the definition of the FINSUP variable in Table 6-8, I designate higher value (i.e., 2) if a central bank is single supervisor, and lower value (i.e., 1) if a central bank shares supervision with other agencies. Thus an existence of insurance scheme causes a lower value of CBSUPWR.

An alternative explanation is that, since banking insurance program contributes to the prudential finance, an economy with the program might have less incentive to enhance the central bank's supervisory function. In other words, savings insurance might be a functional replacement of financial supervision. In this sense, it is not appropriate to interpret the negative correlation as insurance scheme's undermining central bankers' supervision power, or vice versa. In other words, both insurance scheme and central bankers' supervision will act "together" to enhance the prudential financial system.

In sum, roughly speaking, a social group's preference for supervision is the same as its preference for monetary authority. The financial sector may be an exception since, in the previous statistical tests, it has intense positive preference for central bankers' independence while the sector has a positive but weak preference for supervisory authority.

VII. Conclusion: Summary and Interpretations

Hypothesis 1: Capital-Intensive Industry and CBIs

As Table 6-1 and 6-2 show, capital-intensive industry measured by three subsectors (i.e., electronic, metal, and chemical industry) as a percentage of all industry has negative coefficients as I expected, but is not statistically significant. Organized labor also has a negative impact on CBI but it is not significant.

But, considering more information about the economic weights of capital-intensive industry as well as organized labor in a country's production profile, I found, through principal components analyses, that the variable (i.e., CIIPC) is significant and has negative coefficients. This supports my first hypothesis that a country is less likely to have central bank independence if capital-intensive industry and/or organized labor are dominant in an economy.

Hypothesis 2: Non-Capital-Intensive Sectors and CBIs

Table 6-1 and 6-2 show that agriculture and light manufacturing have positive coefficient signs as I expected, but neither are consistently significant. Compared to those two variables, the financial sector is a more consistent predictor since it survived most of all my statistical tests including the principal components tests in Tables 6-4 and 6-5.

On the other hand, two overall measures of agriculture, light manufacture, and the financial sector (i.e., COUNTER and COUNTERPC) are always statistically significant and have positive coefficients, supporting my second hypothesis that a country is more likely to have central bank independence when the financial sector, agriculture, and/or SMEs are dominant in an economy.

But there is a remaining question about agriculture and light manufacturing as well as organized labor. Why are they not so consistent predictors of cross-national CBI? The question can be answered if one considers those sectors' different levels of preference intensity with regard to CBI. As Figure 1-1 illustrates, the financial sector is a robust and consistent pro-CBI group whereas capital-intensive industry is a strong and consistent anti-CBI group. But those sectors in the middle of the spectrum have weak and fuzzy preferences, which results in their inconsistent and/or insignificant regression coefficients despite the coefficient signs that I expected.

Social Preferences and Central Bankers' Independent Supervisory Power

Considering that central bankers in Thailand and Malaysia were effective in maintaining price stability but not in keeping prudential banking sector, I examined correlations that central bankers' supervisory independence have with the power of various social groups. I found that the economic weight of capital-intensive industry is negatively correlated with central bankers' supervision, and positively correlated to financial fragility. In contrast, the weight of the agricultural sector is positively correlated with financial supervision, but negatively correlated with financial weakness. The weight of SMEs, often found in the light manufacturing sector, is weakly correlated with financial supervision. The financial sector does not have any significant correlation coefficient with the supervision or financial fragility. The financial sectors' inconsistent preferences toward price stability and supervision might explain why central bankers at Bangkok and Kuala Lumpur showed the different performances in two areas, although further research on this is needed.

Chapter 7: Conclusion: Politics of Coalition and Central Bankers

I. Introduction

Interested in why the Asian financial crisis of 1997 impacted Taiwan and Korea differently, I researched the uneven development of central banks' independent authority. My dissertation asks, why do some central bankers have autonomous power that contributes to their monetary and financial stability, while others do not? The question addresses the political context under which a government chooses coalition partners among various social groups for its political survival, and how the choice affects central bankers' authority and the financial-monetary regimes they are in charge of.

I explored two main cases (Korea and Taiwan) as well as three additional cases (Singapore, Malaysia, and Thailand). I also employed a large-N cross-sectional data analysis to test my arguments in a broader context. In the next section, I summarize what I have discussed throughout this dissertation. The last section discusses some theoretical contributions, implications, and limitations of my study.

II. Summary

My arguments are as follows: 1) if a government makes a coalition with capital-intensive industry and/or organized labor, politicians are less likely to delegate independent authority to central bankers; and 2) if a government forms a coalition with the financial sector, agriculture, and/or small and medium-sized enterprises, politicians are more likely to delegate independent authority to central bankers.

Chapter 2 compared Korea and Taiwan as the main cases, since the two nations share many similarities in comparative perspective: Confucianism, experience of Japanese colonialism, strong bureaucracies, strong states, their existence as divided nation-states, export-oriented open economies, democratic transitions, successful land reforms, and their subordinate relationships with the U.S. since World War II.

The KMT government in Taiwan learned the political importance of macroeconomic stability from its historical trauma (i.e., defeat on the mainland China). As the "balanced-growth-with-stability" strategy proved successful in the 1950s, the KMT leadership established the Central Bank of China, which has overseen industrial development up to the present day. The KMT's anti-private capitalist ideology and Minsheng principle also contributed to including various sectors like farmers, SMEs, SOE employers, and workers into a loose yet broad developmental coalition. Taiwan is a case of a broad developmental coalition between a pseudo-mass party, the KMT, and social sectors, which I expect to contribute to a strong and independent central banking system.

In contrast, Park's authoritarian regime suffered from a lack of democratic legitimacy. The government thus pushed economic development as its legitimatization vehicle. Furthermore, the government was subject to a short time horizon: it had to prove its economic capacity to the public before the next election. Thus the government employed the "economy of scale" strategy. It chose a few big businessmen as its industrializing agents, and funneled to the manufacturing sector tremendous financial resources in the form of policy loans. Those conditions contributed to the growth-first drive at the costs of macroeconomic and financial instability, which led to dependent central bankers subject to political pressure.

Chapter 3 compared various social groups in the two countries. The Korean industrialization heavily depended on *chaebols*, while discriminating against SMEs and subordinating them to the big firms. In contrast, the Nationalist government supported SMEs that were actually the economic engine of the Taiwanese economy. The government discouraged the development of a big bourgeoisie and, instead, fostered SOEs under its jurisdiction in order to politically survive on the island.

The banking sector, the most effective pro-CBI group, was repressed by the state in Korea to mobilize cheap industrial funds to chaebols that were participating in the HCI project. The inflation-averse financial sector was actually transformed into a risk-taker that was ready to tolerate macroeconomic instability and financial debts, since the developmental government usually intervened in banking crises to guarantee bailouts to commercial banks, turn bad loans into equity, and reschedule repayment terms for debt-ridden big firms. In contrast, the banking sector in Taiwan was controlled by a government that was characterized by fiscal, financial, and monetary conservatism, which contributed to private bankers staying clear of massive industrial financing. Savers and financiers in Taiwan gained more benefits compared to those in Korea, where several bailout episodes occurred in 1969-70, 1972, 1979-80, 1986-88, and 1997-8.

Farmers in Korea were almost discriminated against due to a city-first economic growth strategy. In contrast, the Taiwanese farmers had a better chance to run their businesses thanks to the rural-to-urban economic transition and dispersion of SMEs in rural communities.

Both countries politically demobilized and disorganized industrial workers during their economic miracles, although levels of material compensation for their political losses were totally different. Taiwanese workers were given relatively more material benefits in exchange for the political quietism compared to their Korean counterparts in terms of working hours, unemployment rates, wage differentials, and compensation for occupational injuries.

Chapter 4 argued that the KMT government's broad and balanced social bases resulted in an independent central banking system, while Korea's narrow and chaebol-based political economy led to a dependent central bank vis-à-vis the financial arms of the government. The Park government held the central bankers on a tight leash in order to squeeze industrial financing out of their safes. So the Bank of Korea relegated to the MOF's a "rubber stamp" for their expansionist developmental scheme. Central bankers were incapable of managing inflation within low limits, while extending lavish industrial credits to chaebols. Furthermore, the "outside branch" of the MOF could not regulate and supervise the non-bank financial community, which led Korea into the Asian crisis in late 1997.

The KMT government put top priority on monetary stability. The KMT government fully supported the central bankers' autonomy from spending and planning agencies, and their power to oversee the macroeconomic policy. They were successful in maintaining low inflation and supervising their financial community, which contributed to the Taiwanese economy's survival of the Asian financial crisis.

Chapter 5 addressed the generalizeability of my arguments by exploring additional cases in Southeast Asia: Singapore, Malaysia, and Thailand. The Singaporean case approaches the Taiwan model in terms of the political coalition partners. Facing ostracism by Malaysia, the PAP leadership chose an economic development strategy by which the tiny entrepôt-state could survive national and economic insecurity. They made serious efforts to keep monetary and financial stability to attract foreign financiers and investors to the entrepôt. The PAP government incorporated various groups such as workers, bankers, and industrialists into a balanced coalition, which contributed to the autonomous and effective MAS with institutional support from the MOF.

The UMNO government approaches the Korean model in terms of the industrial financing that was critical for its political survival in an ethnically diverse society. By funneling massive financial resources to the indigenous industrialists, the Malay government fostered the development of the *Bumiputera* class to offset the economic power of ethnic Chinese. In contrast to my expectations, this ethnically motivated industrial financing did not lead to a high turnover rate of governorship, mainly due to the BNM's foreign devolution of its own sovereign monetary authority to Singapore. Malay central bankers' monetary performance has been good, although they lacked the political will to regulate and supervise special and development banks which were financial pillars of the UMNO government's developmental scheme. In sum, the Malay central bank registers a partial central banking regime, in the sense that it exercised independent authority in the monetary area but not in the financial regulation and supervision areas.

Commercial bankers in Bangkok were the major sources of the national wealth in Thailand. Since inflation is a bête noire of commercial banks, the central bankers in Bangkok were good at maintaining low and stable price levels. But, as capital accounts were liberalized after the 1980s, the "finance capital" was active in attracting short-term foreign loans through the channel of the BIBF. Furthermore, bankers were so powerful in lobbying the government, the Thai central bankers could not intervene to regulate and supervise their financial businesses.

In chapter 6, by using statistical analyses of developing countries, I found that the financial sector is a robust and consistent pro-CBI group, whereas capital-intensive industry is a strong and consistent anti-CBI group. But those sectors in the middle of the preference spectrum (i.e., small and medium-sized industry, labor, and farmers) have weak and fuzzy preferences toward the CBI, which results in inconsistent and/or insignificant regression coefficients in my equations.

What are their preferences for central bankers' financial supervision? I tested the correlation coefficients between the central bank's supervisory power and the strength of various social groups. I found that the social groups have the same preferences as they have toward central bank independence. The strength of capital-intensive industry is negatively correlated with central bank's supervision, leading to financial fragility. The agricultural sector has a positive correlation coefficient. Light industry has a positive correlation, but weak correlation with central bank supervision. A caveat is that the financial sector shows an insignificant correlation coefficient with central bank supervision. This suggests that the sector might be reluctant to be supervised by the central bank.

III. Contributions, Implications, and Limitations.

My study emphasizes the importance of central banks especially in a globalization era. The literature of the Asian crisis tends to pay too much attention to mobile capital's speculative attacks on the region, management of foreign exchanges, government – business relations, and impacts of short-term loans, highly leveraged big firms, financial panic and contagion, and overdeveloped NBFIs, etc. It is, however, rare for scholars to focus on the "control tower," central banks in the region.

On the other hand, my study takes on a "fundamentalist" approach to the CBI. I emphasize politicians' choice of coalition partners and its impact on the central banker's independence. The literature of the central banking system tends to posit voluntaristic arguments, but I argue that a central bank's authority is more deep-rooted in and dependent on the domestic coalition-making among capital-intensive industries, the financial sector, agriculture and farmers, workers, and SMEs/light industry. My study implies that if there are no serious efforts to realign the coalitional arrangement, the mere change of a central banking charter and relevant financial laws does not guarantee an autonomous central bank and prudential financial regime.

The literature on CBI tends to focus on stereotyped variables like the legal stipulations of a central bank charter and turnover of governors. My study goes beyond that. By comparing different levels of CBI in Asian countries, I explore 1) how political elites see central bankers when they start an economic growth plan; 2) the power relationships between central bankers and the MOF officials; 3) and how the central bankers' varying levels of independence translates to different qualities of performance such as inflation management and prudential financial regimes.

My research especially brings up the issue of central bankers' financial supervisory authority in determining the CBI of the five countries that my study covers. Throughout the chapters, I examine how much power central bankers actually command in terms of financial supervisory functions as well as macroeconomic management.

Although monetary and financial policies are different from each other, I consider both aspects at the same time, because these two policy areas are critical to central bank independence. This is clear in the "consistent cases" of Korea (i.e., poor monetary and financial management) and Taiwan (good monetary and financial management). Furthermore, by observing both areas at the same time, I find that there are two ways for governmental elites to control central bankers. One is to repress both functions of a central bank as seen in Korea; the other is to support central bankers' monetary authority but to repress their financial supervisory autonomy as seen in Malaysia and Thailand. Malay and Thai governments left monetary initiatives to their central bankers, but prevented central bankers from regulating and supervising the financial realm.

In chapter 6, I test the correlations between the economic strength of various social groups and central bankers' supervision. The analysis suggests that social groups' preferences for the CBI were roughly the same as their preferences for central bank supervisory authority, although the financial sector's preference is somewhat fuzzy and weak toward supervision.

What are the implications of my study in a globalizing era that faces frequent worldwide financial problems? It suggests two conclusions. First, an effective economic system under an independent central bank will be facilitated by the "political integration" of subordinate groups that receive little attention in conservative economic ideology. My study suggests that the "inclusion of diverse groups whose interests partially conflict with those of businesses in the institutionalized network that bind state and society" (Evans 1997: 83) creates strong pressures for economic transparency as well as prudential financial/monetary regimes.

The traditional objection to incorporating subordinate groups such as labor, farmers, and SMEs into socio-economic coalitions is that they will become a dreaded "distributional coalition." Neoliberals argue that if a government is trapped in the distributional ideology, it will exhaust sources of national wealth in the near future. My study suggests that this is not necessarily the case.

The second implication is that the state matters. The neoliberal idea of financial liberalization in developing countries often connotes that the state needs to withdraw from the market and let it function by itself. My study suggests that emerging capital markets in developing countries can stave off the malfunctions of financial liberalization by setting up prudential regulatory regimes controlled by central bankers.[35] In this sense, the "central bank can be seen as the repository of reason against the short-term claims of passion" (Elster 1979: 89). State responsibility for financial transactions within and across borders is still important for economic performance, as opposed to the free-wheeling globalization drive encouraged by the IMF and the World Bank in the 1990s. And the disciplinary capacity of the state matters. Financial liberalization and globalization need to be sought through *re*-regulation rather than *de*-regulation. The central bank can make the process more effective and prudential.

Although my study may contribute to the literature by inserting information about the supervisory function into the traditional definition of the CBI, I did not examine whether the central bank should be a bank supervisor. Instead, an independent supervision agency other than monetary authorities might provide effective supervision. There are intense debates about this very issue (Barth, Caprio, and Levine 2002).

Basically, my study divides the social groups/interests along sectoral cleavages, following a "specific-factors approach." There are, however, other possible dividing lines along which various socio-economic groups can coalesce to get the most from lobbying the government. For example, economic changes in trade, prices in general, and foreign exchanges may cause social actors to line up along the lines of tradables / nontradables, import substitution / exports, and factor endowments (i.e., labor, land, and capital). In

35 As some countries recently set up financial supervisory agencies independent from both central bankers and the finance ministries, there are still debates about whether or not central bankers have to control the financial supervisory function in their jurisdiction.

other words, sectoral groups not the only grouping principle that explains socio-economic interest organization.

Other limitations of my study include that 1) I did not develop a hypothesis about the effects of a coalition between industrialists and commercial bankers; 2) I did not consider the foreign exchange functions of the central bank. These limitations warrant further research.

Tables and Figures

Table 3-1: Chaebols' Share (%) of GDP in the Manufacturing Sector in Korea

Chaebols	1973	1975	1978	1984-5
Top 5	8.8	12.6	18.4	45.0*
Top 10	13.9	18.9	23.4	-
Top 20	21.8	28.9	33.2	-
Top 50	-	-	-	80.0

Source: Koo (1984: 1032)
* Figure for top 4 chaebols

Table 3-2: 100 Largest Firms' Share of GNP in Taiwan (in percentage)

Year	1973	1974	1977	1979	1981	1983
% of GNP	34.0	29.5	29.1	32.8	30.0	31.7
% of employees	5.1	5.1	5.0	4.9	4.6	4.7

Source: Chunghua Weihsinso (1992 and 1993)

Table 3-3: Ten Largest Companies in Korea and Taiwan, 1987

country	Rank/company	main industry	Sales*	employees	Ownership
Korea	1) Samsung	Electronics	21,053.5	160,596	Local private
	2) LG	Electronics	14,422.3	88,403	Local private
	3) Daewoo	Electronics	13,437.9	94,888	Local private
	4) SK	Petroleum	6,781.6	17,985	Local private
	5) Ssangyong	Petroleum	4,582.7	16,870	Local private
	6) Korea Explosives	Chemicals	3,563.8	18,291	Local private
	7) Pohang Iron & Steel	Iron and steel	3,533.2	19,329	State
	8) Hyundai Motor	Motor vehicles	3,437.4	29,000	Local private
	9) Hyosung	Textile	3,257.8	24,000	Local private
	10) Hyundai Heavy Industries	Transportation equipments	2,964.5	48,200	Local private
Taiwan	1) Chinese Petroleum	Petrochemicals	5,491.0	20,700	State
	2) Taiwan Tobacco & Wine	Food & beverage	2,277.1	13,495	State
	3) Nan Ya Plastics	Petrochemicals	1,423.7	11,883	Local private
	4) China Steel	Steel	1,287.8	9,476	State
	5) Formosa Plastics	Petrochemicals	946.8	5,352	Local private
	6) Ret-Ser Engineering	Construction	852.0	13,358	State
	7) Tatung	Electronics	836.2	14,139	Local private
	8) Formosa Chemicals & Fiber	Textiles and dyeing	702.9	8,377	Local private
	9) Yue Loong Motor	Motor vehicles	687.4	3,782	Local private
	10) San Yang Industry	Motor vehicles	600.9	3,637	Local private

Source: *Fortune* (August 1988); *Common Wealth* (July 1988)
* U.S.$ millions

Table 3-4: Cross-National Share* of SOEs in Nonagricultural GDP

Country/region	1968-1971
18 Latin American & Caribbean economies	11.6
14 African economies	17.1
8 Asian economies	10.9
8 industrial economies	8.3
India	17.4
Indonesia	19.9
Korea	11.3
Taiwan (1950s-60s)	21
Taiwan (1980s-90s)	14-17

Source: Hsueh, Li-min, Chen-Kuo Hsu, and Dwight H. Perkins (2001: 106)
* figures are unweighted averages in percent

Table 3-5: Cross-National GDP shares of the Ten Largest Firms, 1987 (US$ millions)

country	Sales of top ten firms (A)	GDP (B)	Ratio (A/B)
Mexico	20,917.8	141,940	14.7
Brazil	31,312.5	299,230	10.5
Korea	77,034.7	121,310	63.5
Taiwan	15,105.8	105,750	14.3

Source: Gereffi (1990: 96)

Table 3-6: World's Biggest 500 Industrial Corporations, 1988 (sales in US$ million).

country	1-100	101-200	201-300	301-400	401-500	Total
Argentina	0	1	0	0	0	1
Brazil	1	1	0	2	1	5
Chile	0	0	1	0	0	1
India	1	0	3	2	1	7
Indonesia	0	0	0	0	1	1
Malaysia	0	0	1	0	0	1
Mexico	1	0	0	0	1	2
Korea	3	3	3	1	1	11
Spain	2	0	3	1	2	8
Taiwan	0	1	0	0	3	4
Turkey	0	3	0	0	0	3
Venezuela	1	0	0	0	0	1

Source: *Fortune* (July 31, 1989: 290-299)

Table 3-7: Profitability of Manufacturing firms in Korea and Taiwan, 1987-1997

year		1987	1989	1991	1993	1995	1997	avrg*
Korea	A	10.71	6.42	5.62	4.22	11.03	-4.21	7.22
	B	3.58	2.50	1.78	1.70	3.60	-0.34	2.64
Taiwan	A	23.65	17.89	11.92	8.67	10.17	n.a.	13.76
	B	5.8	5.00	4.0	2.9	5.1	n.a.	4.38

Source: The Bank of Korea (1987-97)
A: profit / asset; B: profit / sales
* average between 1987 and 1995

Table 3-8: SMEs' Share of Export in Korea and Taiwan, 1981-1988 (US$ hundred millions)

Year	Korea			Taiwan		
	export (a)	SMEs' export (b)	ratio (b/a), %	export (a)	SMEs' export (b)	ratio (b/a), %
1981	n.a.	n.a.	n.a.	226.0	153.9	68.1
1982	218.5	48.2	22.1	222.0	154.7	69.7
1983	244.5	48.9	20.0	251.2	159.3	63.4
1984	292.4	74.4	25.4	304.6	180.5	59.2
1985	302.3	84.1	27.8	307.2	188.0	61.2
1986	347.1	122.3	35.2	390.9	264.1	67.6
1987	472.3	178.1	37.7	535.3	359.0	67.1
1988	606.9	231.5	38.1	n.a.	n.a.	n.a.

Source: Abe and Kawakami (1996: 164)

Table 3-9: Country Breakdown of Banks in Top 200 Asian Survey.

country	No. of banks	asset (US$m)	return on capital (%)	return on assets (%)	rating index*
Australia	15	324,928	18.96	0.99	3.0
China	5	418,807	21.00	1.19	8.0
Hong Kong	19	193,899	na	na	6.5
India	22	137,611	9.77	0.29	na
Indonesia	18	70,458	21.10	1.11	na
Korea	29	310,152	7.84	0.52	5.0
Malaysia	16	39,929	17,47	1.01	6.0
New Zealand	3	16,897	3.04	0.13	4.0
Philippines	16	15,351	27.14	3.14	na
Singapore	6	55,665	4.57	0.43	3.5
Taiwan	18	222,736	29.52	1.09	3.0
Thailand	16	75,146	19.90	1.21	5.7

Source: *The Banker* (October 1991)
* the highest score is 1, the lowest 10. The lower, the better.

Table 3-10: Allocation of U.S. Aid to Taiwan and Korea, 1950s-60s (percentage of total).

	Taiwan	Korea
Infrastructure	37.3	50
Agriculture	21.5	4
Human resources	25.9	10
Industry	15.3	29
other	0	7

Source: Jacoby (1966: tables IV-3 and IV-4, and appendix B); Mason et al. (1980: 191)

Table 3-11) Breakdown of Manufacturing Firms in Korea and Taiwan (in percentage)

no. of employees	Korea (1988)				Taiwan (1991)			
	A	B	C	D	A	B	C	D
1~ 9	77	11.6	5.3	3.5	65.7	14.8	11.4	8.1
10~49	17.3	20.8	16.5	13.2	28.1	31.5	26.1	22.6
50~99	3	11.5	10.5	9	3.7	13.9	13.1	12.9
100~499	2.3	24.1	25.2	25	2.3	24.3	27.7	29.5
500~	0.4	32.1	42.5	48	0.3	15.6	21.8	26.8

Source: Abe and Kawakami (1996: 150-151)
A: number of firms (in percentage of total firms)
B: number of employees (in percentage of total employees)
C: wages
D: production

Table 3-12: Industrial Disputes in Korea and Taiwan, 1961-2000

years	Korea			Taiwan		
	A	B	C	A	B	C
1961-65	53	10313	195	27	1107	41
1966-70	12	16591	1383	12.6	1689	134
1971-75	24	6739	281	318	13200	42
1976-80	104	17674	170	492	7600	15
1981-85	150	19951	133	1212	10600	9
1986-87	2013	490900	244	1523	19427	13
1988-90	1271	278878	220	1880	48240	26
1991-95	164	108531	660	1929	24053	12
1995-2000	148	107792	728	4308	57651	14

Source: National Statistical Office (1995: 399); Ministry of Labor (1961-2000)
A: average number of industrial disputes;
B: average number of workers involved;
C: average number of workers involved per dispute

Table 4-1: Change of Government, Regime Type, and BOK Governors in Korea

President	Regime	BOK Governor	Terms of office
Rhee, Syngman	semi-democratic	Ku, Yong-So	Jun.1950~Dec. 1951
		Kim, Yu-Taek	Dec. 1951~Dec. 1956
		Kim, Chin-Hyong	Dec. 1956~May 1960
Chang, Myon	Democratic	Bae, Ui-Hwan	Jun.1960~Sep.1960
		Chun, Ye-Yong	Sep.1960~May 1961
Park, Chung Hee	military	Yu, Chang-Sun	May 1961~May 1962
		Min, Byung-Do	May 1962~Jun. 1963
		Lee, Chung-Hwan	Jun. 1963~Dec. 1963
		Kim, Se-Ryon	Dec.1963~Dec. 1967
		Seo, Chin-Su	Dec.1967~May 1970
		Kim, Sung-Hwan	May 1970~May 1978
Chun, Doo Hwan	military	Shin, Byung-Hyon	May 1978~Jul.1980
		Kim, Chun-Sung	Jul.1980~Jan. 1982
		Ha, Young-Ki	Jan. 1982~Oct. 1983
		Choi, Chang-Rak	Oct.1983~Jan. 1986
		Park, Sung-Sang	Jan. 1986~Mar. 1988
Roh, Tae Woo	semi-democratic	Kim, Kun	Mar. 1988~Mar. 1992
		Cho, Sun	Mar. 1992~Mar. 1993
Kim, Young Sam	democratic	Kim, Myong-Ho	Mar. 1993~Aug. 1995
		Lee, Kyung-Sik	Aug. 1995~Mar. 1998
Kim, Dae Jung	democratic	Chun, Chul-Hwan	Mar.1998~Mar. 2002
Roh, Mu Hyun	democratic	Park, Sung	Mar. 2002~

Source: The Bank of Korea (2000)

Table 4-2: Loans and Investments of Financial Institutions (% of total credit) in Korea

year	Comm [a]	special [b]	develop [c]	invest [d]	savings [e]	insurance	securities
1970s	42.80	32.57	16.70	0.00	6.54	1.39	0.00
1980s	37.75	23.23	15.34	7.42	9.00	3.85	3.41
1990s	20.55	10.33	7.13	13.17	26.49	7.98	14.36

Source: Bank of Korea, *Economic Statistics Yearbook*, various years

[a] commercial banks

[b] specialized banks

[c] development funds

[d] investment companies

[e] trust accounts at banks amounts to 6.54, 7.25, and 16.4 percent in each period.

Table 4-3: Chairmanship at the Financial Supervisory Service in Korea, 1998-2005.

No.	Name	Terms of office	Career & Background
1	Lee, Hyun-Jae	Mar.1998~Jan.2000	MOFE minister
2	Lee, Yong-Keun	Jan.2000~Aug.2001	Chairman of FSC and FSS
3	Lee, Keun-Young	Aug.2001~Mar.2003	MOFE official, private banks
4	Lee, Jung-Jae	Mar.2003~Aug.2004	Vice-minister of MOFE
5	Yoon, Jeung-Hyun	Aug.2004~	Director of MOFE

Source: FSS websites, accessed July 15, 2005.
http://www.fss.or.kr/kor/abu/ceo/wewonjang.jsp?menu=abu010200
http://www.fss.or.kr/kor/abu/ceo/ceohistory01.jsp?menu=abu010800

Table 4-4: Price Indexes During Wartime Period in Mainland China, 1938-1945

Year	Free China	Chungking	Chengtu	Kangting
1937	100	100	100	100
1938	131	126	128	137
1939	220	220	225	225
1940	513	569	665	587
1941	1,296	1,576	1,769	1,352
1942	3,900	4,408	4,559	4,388
1943	12,541	13,298	14,720	12,982
1944	43,197	43,050	56,965	49,229
1945	163,160	156,195	170,379	171,053

Source: Chang (1958: 371)

Table 4-5: Government Finance in Mainland China, 1937-48 (in CNC $ millions)

Year	Expenditure	Revenue	Deficit
1937	1,992	1,393	560
1938	2,215	723	1,492
1939	2,797	740	2,057
1940	5,288	1,325	3,963
1941	10,003	1,310	8,693
1942	24,511	5,630	18,881
1943	58,816	20,403	38,413
1944	171,689	38,503	133,186
1945	2,348,085	1,241,389	1,106,698
1946	7,574,790	2,876,988	4,697,802
1947	43,393,895	14,064,383	29,329,512
1948	655,471,087	220,905,475	434,565,612

Source: Chang (1958: 374).

Table 4-6: The CBC Governors on the Mainland

CBC governors	Terms of Offfice
Tse-wen Sung	Oct. 1928 ~ Apr. 1933
Hsiang-hsi Kung	Apr. 1933 ~ Jul. 1945
Hung-Chun Yu	Jul. 1945 ~ Feb. 1946
Tsu-yi Pei	Feb. 1946 ~ Mar. 1947
Chia-ao Chang	Mar. 1947 ~ May 1948
Hung-chun Yu	May 1948 ~ Jan. 1949
Kung-yun Liu	Jan. 1949 ~ Jun. 1949
Kan Hsu	Jun. 1949 ~ Oct. 1949

Source: CBC (1996: 195)

Table 4-7: The CBC Governors in Taiwan Prior to the Resumption of Operations

CBC governors	Terms of office
Chi-yu Kuan	Oct. 1949 ~ Feb. 1950
Hung-Chun Yu	Feb. 1950 ~ Jun. 1960
Fei-perng Yu*	Jun. 1960 ~ Jul. 1960

Source: CBC (1996: 195)
* deputy governor acted on behalf of the governor.

Table 4-8: The CBC Governors in Taiwan After the Resumption of Operations

CBC governors	Terms of office
Po-yuan Hsu	Jul. 1960 ~ May 1969
Kuo-hwa Yu	May 1969 ~ May 1984
Chi-cheng Chang	Jun. 1984 ~ May 1989
Samuel C. Shieh	Jun. 1989 ~ May 1994
Kuo-shu Liang*	June 1994 ~ Mar. 1995
Yuan-dong Sheu**	Mar. 1995 ~ Feb. 1998
Fai-nan Perng	Feb. 1998 ~ Present

Source: CBC (1996: 196-9).
*) Liang was out of office due to an accident. Interview of a legislator, summer of 2003, Taipei, Taiwan.
**) Sheu was out of office due to his poor performance as a governor, interview of a legislator, summer of 2003, Taipei, Taiwan

Table 4-9: Loans and Investments of Financial Institutions in Taiwan, 1961-2001.

Institutions	1961	1970	1980	1990	2001
Full-service banks	82.0	76.4	67.5	68.3	84.0*
Foreign banks	0.4	3.1	7.6	3.7	3.0
SME banks	3.8	4.9	4.8	10.0	n.a.
Credit co-ops	7.1	7.1	7.0	9.2	2.5
Credit department**	4.7	4.4	4.7	6.3	3.9
Investment & trust companies	1.6	1.9	6.3	6.0	1.0
Postal savings	0.3	0.5	0.2	0.2	n.a.
Insurance companies	0.3	0.7	1.8	5.5	5.5
Total	100	100	100	100	

Source: MOF (1975, 1990); CBC (2003).
* Full-service banks' share includes SME banks' share in 2001 statistics.
** Credit departments of farmers' and fishermen's associations.

Table 5-1: MAS chairmen and their terms of office in Singapore

MAS chairmen	Terms of office
Hon Sui Sen	Jan. 1971 ~ Jul. 1980
Goh Keng Swee	Aug. 1980 ~ Jan. 1985
Richard Hu	Jan. 1985 ~ Dec. 1997
Lee Hsien Loong	Jan. 1998 ~ Aug. 2004
Goh Chok Tong	Aug. 2004 ~

Source: MAS (http://www.mas.gov.sg/masmcm/bin/pt1Introduction_to_MAS.htm). accessed August 29, 2005.

Table 5-2: Governors of The Bank of Thailand, 1942 ~ 2005

	governors	regime	Period in office
1	H.H. Prince Vivadhanajaya	Military	Nov. 1942 ~ Oct. 1946
2	Serm Vinicchayakul	Democratic	Oct. 1946 ~ Nov. 1947
3	Leng Srisomwongse	Military	Nov. 1947 ~ Sep. 1948
4	H.H. Prince Vivadhanajaya	Military	Sep. 1948 ~ Dec. 1948
5	Leng Srisomwongse	Military	Dec. 1948 ~ Aug. 1949
6	Dej Snidvongs	Military	Aug. 1949 ~ Feb. 1952
7	Serm Vinicchayakul	Military	Feb. 1952 ~ Jul. 1955
8	Kasem Sriphayak	Military	Jul. 1955 ~ Jul 1958
9	Jote Guna-Kasem	Military	Jul 1958 ~ May 1959
10	Puey Ungphakorn	Military	Jun. 1959 ~ Aug. 1971
11	Bisudhi Nimmanhaemin	Democratic	Aug. 1971 ~ May 1975
12	Snoh unakul	Democratic	May 1975 ~ Oct. 1979
13	Nukul Prachuabmoh	Semi-Dem.	Nov. 1979 ~ Sep. 1984
14	Kamchorn Sathirakul	Semi-Dem.	Sep. 1984 ~ Mar. 1990
15	Chavalit Thanachanan	Democratic	Mar. 1990 ~ Sep. 1990
16	Vijit Supinit	Military	Oct. 1990 ~ Jul. 1996
17	Rerngchai Marakanond	Democratic	Jul. 1996 ~ Jul. 1997
18	Chaiyawat Wibulswasdi	Democratic	Jul. 1997 ~ May 1998
19	Chatu Mongol Sonakul	Democratic	May 1998 ~ May 2001
20	Pridiyathorn Devakula	Democratic	May 2001 ~ Current

Source: BOT (http://www.bot.or.th/bothomepage/BankAtWORK/AboutBOT/Organize/ListOfGovernors_E.htm). accessed on Jun. 28, 2005.

Table 5-3: Average Governor Turnover Per Year, 1961-2001

periods	Singapore	Taiwan	Thailand	Korea
1961 – 1970	n/a	0.1	0.0	0.6
1971 – 1980	0.1	0.0	0.2	0.1[b]
1981 – 1990	0.1	0.2	0.3	0.4
1991 – 2001	0.1	0.27[a]	0.45	0.5

Source: the author's calculation based on four countries' central bank websites.

[a] The slight increase of turnover rate is due to unexpected deaths of Kuo-shu Liang from a chronic disease in 1995, and of Yung-dong Sheu from a airplane crash in 1998. interview with a legislator of the People First Party, summer 2003, Taipei Taiwan.

[b] The low TOR is due to the fact that the 11th governor Kim Sung-Hwan (1970 – 1978) has a reputation of obedience to the MOF.

Table 5-4: Indices for Quality of Financial Supervision for 5 Asian Countries.

Index	Taiwan	Singapore	Malaysia	Korea	Thailand
Sum of indices	7	6	5	3	1
Disclosure of risk management [a]	1	1	0	0	0
Supervisors' action without bank approval [b]	0	1	1	0	0
Requirement for auditor to report [c]	1	1	1	0	0
Supervisors' legal action against auditors' negligence [d]	0	1	1	0	0
Supervisors' power to change a bank's organization [e]	1	0	1	0	0
Credit ratings of bank [f]	1	0	0	0	0
Liability of supervisors to their action [g]	1	1	1	1	0
Explicit deposit insurance scheme [h]	1	0	0	1	0
Minimum liquidity requirement [i]	1	0	0	0	1
# of supervisors per institution [j]	0	1	0	1	0

Source: Barth, Caprio, and Levine (2001)

[a] "Must banks disclose risk management procedures to public?": yes=1; no=0

[b] "Can supervisors meet external auditors to discuss report without bank approval?": yes=1; no=0.

[c] "Are auditors legally required to report misconduct by managers and directors to supervisory agency?": yes=1; no=0

[d] "Can legal action against external auditors be taken by supervisor for negligence?": yes=1; no=0

[e] "Can supervisors force banks to change internal organizational structure?": yes=1; no=0

[f] "Do regulations require credit ratings for commercial banks?": yes=1; no=0.

[g] "Are supervisors legally liable for their actions?": yes=0; no=1.

[h] "Is there an explicit deposit insurance scheme?": yes=1; no=0.

[i] "What is the minimum liquidity requirement?": above avrg=1; below avrg=0.

[j] "What is the number of professional bank supervisors per institution?": above avrg=1; below avrg=0.

Table 5-5: Interest Rate Spread, 1977-2001

Country	average	77-80	81-84	84-87	88-91	92-95	96-99	00-01
Korea	0.54	-1.5	1.95	0.210	0.34	0.04	1.46	1.26
Singapore	3.06	2.36	2.86	2.954	2.97	2.98	3.16	4.12
Thailand	3.30	3.68	3.67	2.932	2.18	2.48	3.55	4.62
Malaysia	2.26	2.15	0.69	3.31	2.17	1.93	2.21	3.35

Source: World Bank (2003)

Table 5-6: The BNM governors and their terms of office, 1959-2005

governor	Terms of office
Tan Sri W.H.Wilcock	Jan.1959 ~ Jul. 1962
Tun Ismail bin Mohamed Ali	Jul. 1962 ~ Jul. 1980
Tan Sri Abdul Aziz bin Taha	Jul. 1980 ~ Jun. 1985
Tan Sri Dato' Jaffar bin Hussein	Jun. 1985 ~ May 1994
Tan Sri Dato' Ahmad Bin Mohd Don	May 1994 ~ Sep. 1998
Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman	Sep. 1998 ~ Apr. 2000
Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz	May 2000 ~

Source: Bank Negara Malaysia (http://www.bnm.gov.my/index.php?ch=7&pg=2&ac=5). accessed on June 4, 2005.

Table 6-1: Determinants of Behavioral CBI in Developing Countries during the 1980s
Dependent variable = behavioral CBI

	Model 1	*Model 2*	*Model 3*	*Model 4*	*Model 5*	*Model 6*
AGRI	0.0075*			0.087*		0.0041
	(0.0036)			(0.0032)		(.0034)
FINPWR	0.0440	0.0677***	0.0699***	0.0563**		0.0582**
	(0.0290)	(0.0224)	(0.0245)	(0.0245)		(.0236)
UNION	-0.0034					
	(0.0024)					
LIGHT		0.0055**				0.0036
		(0.0023)				(0.0028)
COUNTER					0.0051***	
					(.0014)	
HEAVY			-0.0045	-0.0019		
			(0.0032)	(0.0033)		
PARTISAN	0.0061	-0.0016	-0.0021	0.0012	-0.0007	0.0005
	(0.0057)	(0.0042)	(0.0045)	(0.0047)	(.0046)	(0.0046)
PBC	-0.2013	-0.1354	-0.0698	-0.0546	-0.2050	-0.1048
	(0.1890)	(0.1736)	(0.1825)	(0.0618)	(0.1755)	(0.1737)
SUCCESSOR	0.0865	-0.0355	-0.0241	0.0227	0.0360	0.0016
	(0.0775)	(0.0549)	(0.0590)	(0.0618)	(0.0567)	(0.0626)
GOVDEBT	0.0001	0.0002	0.0001	-0.0000	-0.0001	0.0000
	(0.0009)	(0.0007)	(0.0008)	(0.0008)	(0.0008)	(0.0007)
INTLECO	-0.0001	-0.0002	-0.0002	-0.0001	0.0001	-0.0001
	(0.0005)	(0.0006)	(0.0007)	(0.0007)	(0.0006)	(0.0006)
INFLA	-0.047**	-0.0159	-0.0158	-0.0299*	-0.0321**	-0.0258
	(0.0183)	(0.0138)	(0.0148)	(0.0161)	(0.0147)	(0.0160)
R^2	0.7415	0.5863	0.5219	0.5887	0.5093	0.6139
N	26	30	30	30	30	30

Standard errors are in parentheses.
*** significant at 0.01 level
** significant at 0.05 level
* significant at 0.1 level

Table 6-2: Determinants of Overall CBI in Developing Countries during the 1980s
Dependent variable = overall CBI

	Model 1	*Model 2*	*Model 3*	*Model 4*	*Model 5*	*Model 6*
AGRI	0.0007			0.0006		0.0004
	(0.0009)			(0.0008)		(0.0008)
FINPWR	0.0107	0.0129**	0.0132**	0.0117*		0.0120*
	(0.078)	(0.0054)	(0.0056)	(0.0060)		(0.0059)
UNION	-0.0005					
	(0.0006)					
LIGHT		0.0006				0.0005
		(0.0005)				(.0007)
COUNTER					0.0007**	
					(0.0003)	
HEAVY			-0.0005	-0.0002		
			(0.0034)	(0.0008)		
PARTISAN	0.0013	0.0005	0.0004	0.0008	0.0005	0.0007
	(0.0015)	(0.0010)	(0.0010)	(0.0011)	(0.0011)	(0.0011)
PBC	-0.0598	-0.0246	-0.0162	-0.0146	-0.0409	-0.0216
	(0.0512)	(0.0423)	(0.0422)	(0.0426)	(0.0425)	(0.0435)
SUCCESSOR	0.0144	-0.0001	0.0012	0.0064	0.0117	0.0034
	(0.0210)	(0.0133)	(0.0136)	(0.0151)	(0.0137)	(0.0157)
GOVDEBT	-0.0000	-0.0000	-0.0000	-0.0000	-0.0001	-0.0000
	(0.0002)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)
INTLECO	0.0001	-0.0000	0.0000	0.0000	0.0001	0.0000
	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)
INFLA	-0.0102*	-0.0064*	-0.0064*	-0.0079*	-0.0090**	-0.0074*
	(0.0049)	(0.0033)	(0.0034)	(0.0039)	(0.0035)	(0.0040)
R^2	0.6054	0.4753	0.4530	0.4703	0.3835	0.4810
N	26	30	30	30	30	30

Standard errors are in parentheses.
*** significant at 0.01 level
** significant at 0.05 level
* significant at 0.1 level

Table 6-3: Correlation Matrix between Variables

	Unionized laror	*Size of manufacture*	*Fixed capital. Formation*	*Max. fixed capital formation*	*Min. fixed capital formation*	*Heavy industry*
Unionized Lavor	1.0000					
Size of manufacture	0.5844* (0.0030)	1.0000				
Fixed capital formation	0.4221* (0.0226)	0.2937 (0.1220)	1.0000			
Max. of fixed capital formation	0.3951* (0.0339)	0.2703 (0.1561)	0.8505* (0.0000)	1.0000		
Min. of fixed capital formation	0.0035 (0.9858)	0.4570* (0.0127)	0.3563* (0.0386)	0.2649 (0.1300)	1.0000	
Heavy industry	0.3127* (0.0987)	0.4592* (0.0122)	0.6081* (0.0001)	0.4998* (0.0026)	0.4641* (0.0057)	1.0000

Star (*) were added for correlation coefficients significant at the 0.1 level or better.

Table 6-4: Principal Components Analysis of Capital-Intensive Industry and Behavioral CBI in Developing Countries during the 1980s
Dependent variable = behavioral CBI

	Model 1	*Model 2*	*Model 3*	*Model 4*
CIIPC	-0.0611**		-0.1036***	-0.0741**
	(0.0277)		(0.0254)	(0.0274)
FINPWR	0.0819**	0.0800***		0.0598*
	(0.0287)	(0.0240)		(0.0293)
PARTISAN	-0.0035	-0.0019	0.0030	0.0003
	(0.0042)	(0.0046)	(0.0053)	(0.050)
PBC	-0.0006	-0.0247	-0.1165	-0.0819
	(0.2260)	(0.1836)	(0.2374)	(0.2176)
SUCCESSOR	-0.0756	-0.0278	0.0552	0.0042
	(0.0548)	(0.0602)	(0.0866)	(0.0830)
GOVDEBT	0.0009	0.0002	-0.0003	0.0003
	(0.0011)	(0.0008)	(0.0006)	(0.0014)
INTLECO	-0.0000	-0.0007	0.0003	0.0000
	(0.0006)	(0.0006)	(0.0006)	(0.0006)
INFLA		-0.0164	-0.0395**	-0.0278*
		(0.0152)	(0.0168)	(0.0164)
R^2	0.6255	0.4766	0.6170	0.7001
N	25	30	24	24

Standard errors are in parentheses.
*** significant at 0.01 level
** significant at 0.05 level
* significant at 0.1 level

Table 6-5: Principal Components Analysis: Capital-Intensive Industry and Overall CBI in Developing Countries during the 1980s
Dependent variable = overall CBI

	Model 1	*Model 2*	*Model 3*	*Model 4*
CIIPC	-0.0075		-0170**	-0.0120*
	(0.0073)		(0.0060)	(0.0068)
FINPWR	0.0170**	0.0145**		0.0102
	(0.0075)	(0.0053)		(0.0073)
PARTISAN	-0.0004	0.0005	0.0014	0.0009
	(0.0011)	(0.0010)	(0.0012)	(0.0012)
PBC	-0.0219	-0.0106	-0.0528	-0.0469
	(0.0595)	(0.0412)	(0.0559)	(0.0545)
SUCCESSOR	-0.0180	0.0007	0.0214	0.0126
	(0.0144)	(0.0135)	(0.0204)	(0.0208)
GOVDEBT	0.0001	-0.0000	-0.0001	-0.0001
	(0.0002)	(0.0001)	(0.0003)	(0.0003)
INTLECO	0.0001	0.0000	0.0002	0.0001
	(0.0001)	(0.0001)	(0.0001)	(0.0645)
INFLA		-0.0065*	-0.0114***	-0.0094**
		(0.0034)	(0.0039)	(0.0041)
R^2	0.4501	0.4377	0.5539	0.6049
N	25	30	24	24

Standard errors are in parentheses.
*** significant at 0.01 level
** significant at 0.05 level
* significant at 0.1 level

Table 6-6: Principal Components Analysis of Non-HEAVY Industry and Behavioral CBI in Developing Countries during the 1980s
Dependent variable = behavioral CBI

	Model 1	*Model 2*
COUNTERPC	0.1115***	0.1115***
	(0.0263)	(0.0246)
PARTISAN	-0.0026	0.0006
	(0.0039)	(0.0042)
PBC	-0.0827	-0.1462
	(0.1722)	(0.1589)
SUCCESSOR	-0.0414	0.0211
	(0.0434)	(0.0515)
GOVDEBT	0.0002	-0.0001
	(0.0006)	(0.0007)
INTLECO	0.0002	0.0000
	(0.0006)	(0.0005)
INFLA		-0.0301**
		(0.0133)
R^2	0.4784	0.5937
N	31	30

Standard errors are in parentheses.
*** significant at 0.01 level
** significant at 0.05 level
* significant at 0.1 level

Table 6-7: Principal Components Analysis: Non-HEAVY Industry and Overall CBI in Developing Countries during the 1980s
Dependent variable = overall CBI

	Model 1	*Model 2*
COUNTERPC	0.0165**	0.0172**
	(0.0067)	(0.0062)
PARTISAN	-0.0003	0.0008
	(0.0009)	(0.0010)
PBC	-0.0160	-0.0325
	(0.0442)	(0.0401)
SUCCESSOR	-0.0096	0.0096
	(0.0111)	(0.0130)
GOVDEBT	0.0000	-0.0000
	(0.0001)	(0.0001)
INTLECO	0.0002	0.0001
	(0.0001)	(0.0001)
INFLA		-0.0088**
		(0.0033)
R^2	0.2566	0.4452
N	31	30

Standard errors are in parentheses.
*** significant at 0.01 level
** significant at 0.05 level
* significant at 0.1 level

Table 6-8: Measurement of Variables

variables	Measurement
CBSUPWR [a]	Stands for central bankers' independent power to supervise. = FINSUP+FINACC
FINSUP [a]	= 2, if a central bank is single supervisor. =1, if a central bank shares supervision with other agencies. = 0, if a finance ministry is the supervisor.
FINACC [a]	= 1, if a central bank is accountable to no agency or its own governor. =0, if a central bank is accountable to a government agency.
PRINFINFRAG [a b]	Stand for financial fragility and vulnerability. Value gained by principal component method using logged NPL, level of non-liquidity, and M2fx.
NPL [a]	Ratio of non-performing loans to total assets
NONLIQUID [a]	non-liquidity (=100-liquidity)
M2FX [b]	Ratio of money and quasi money (M2) to gross international reserves
AGRI [b]	Agriculture, value added (% of GDP)
FINPWR [a b]	(universal-fractionalization+concentration)*m2/GDP[c]
CIIFIXED [b]	Stands for capital-intensive sector. Credits to private sector x fixed capital formation as % of GDP.
LIGHT [b]	Stands for SME sector. 5 sectors (food, beverage, tobacco, textile, clothing) as % of value added in manufacturing
GOVOWN [a]	Stands for a government's control of banking sector. % of banking system's assets in banks that are 50% or more government owned.
SHTRMDET [b]	Short-term debt (% of total external debt)
INFLA [b]	Inflation, consumer prices (annual %)
INSURE[a]	=1, if a country has a deposit insurance scheme, =0, if a country does not have a deposit insurance scheme.

Source: [a] James Barth et al. Database, 2001
[b] World Bank, WDI CD-ROM, 2003
[c] available from the text of the current chapter.

Table 6-9: Correlation of Social Interests with Supervisory Power and Financial Fragility

variable	*CBSUPWR*	*PRINFRAG*
CBSUPWR	1.0000	-0.2815**
PRINFRAG	-0.2815**	1.000
AGRI	0.2859**	-0.4207***
FINPWR	0.0207	0.2257
CIIFIXED	-0.2374*	0.3964***
LIGHT	0.2293	-0.2194
GOVTOWN	0.0452	-0.2026
SHTRMDET	0.0370	0.3961***
INFLA	-0.2220*	-0.1134
INSURE	-0.2532**	0.0660

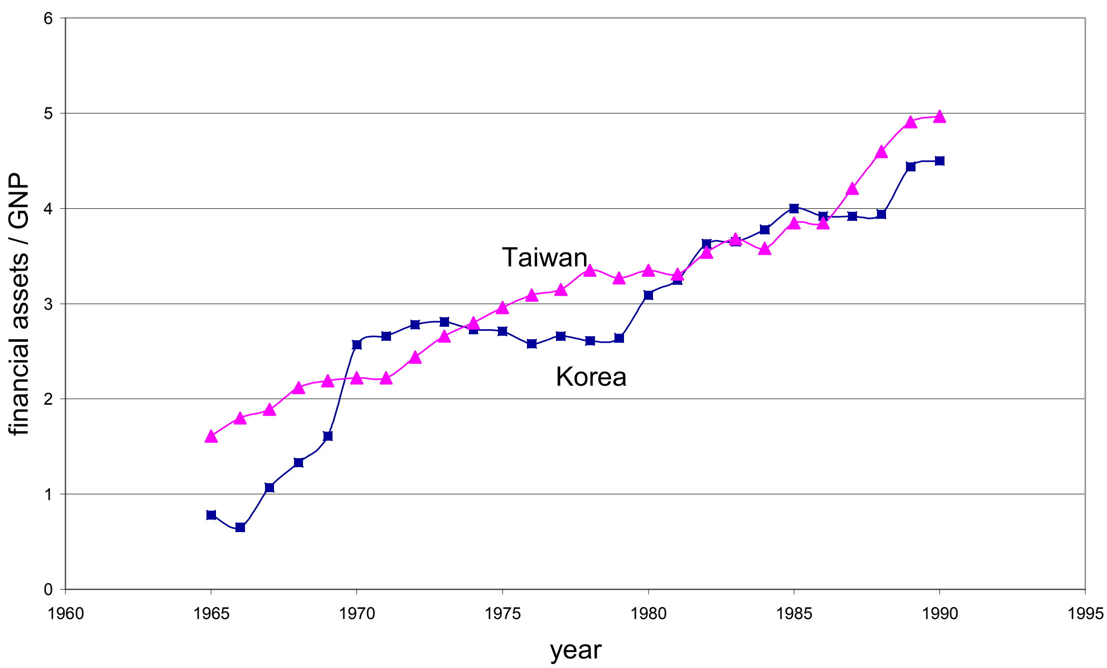
*** significant at 0.01 level
** significant at 0.05 level
* significant at 0.1 level

Figure 1-1: The Spectrum of Groups' Preferences for Macroeconomic Instability

Capital-intensive industry	Organized labor	SMEs and farmers	finance

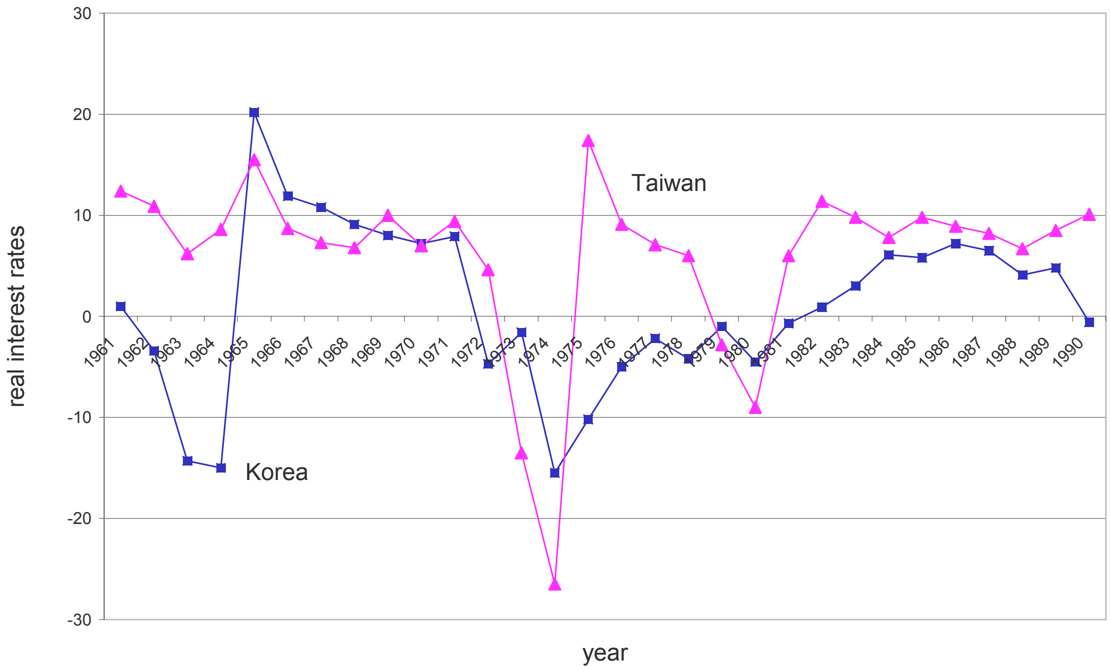
← pro-growth; less stability-oriented pro-stability; less growth-oriented →

Figure 3-1: Financial Development in Korea and Taiwan



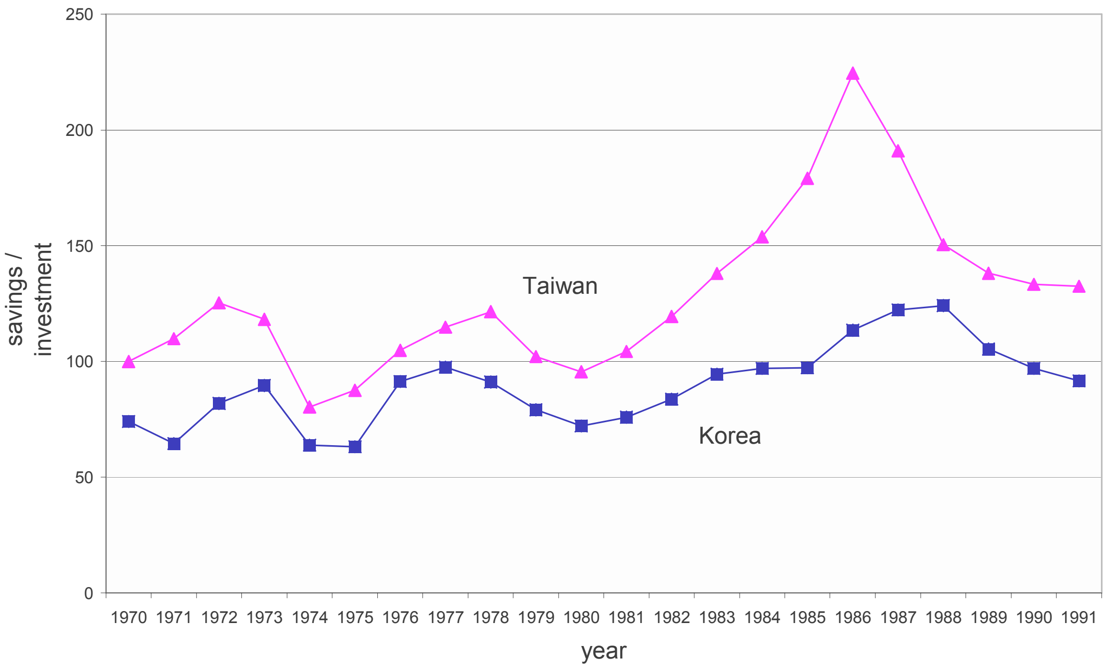
Source: World Bank (2003); National Statistical Office (1995); Republic of China (1984, 1990, 1997a); Republic of China (1990, 1997b)

figure 3-2: Real Interest Rates in Korea and Taiwan



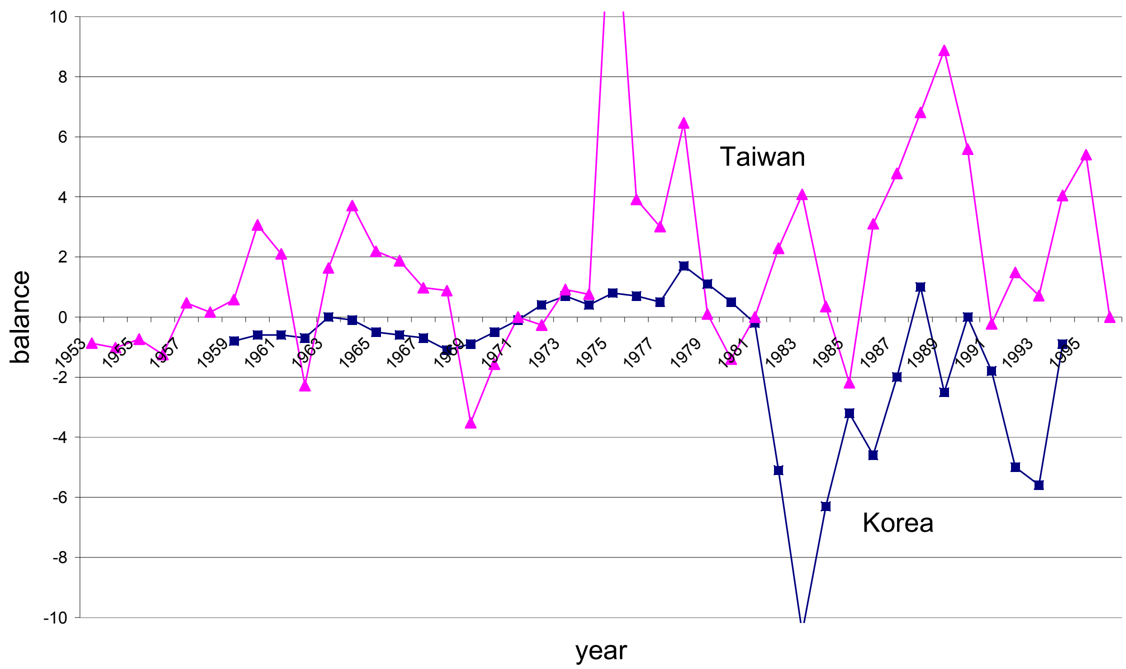
Source: World Bank (2003); National Statistical Office (1995); Republic of China (1984, 1990, 1997a); Republic of China (1990, 1997b)

Figure 3-3: Savings and Investment



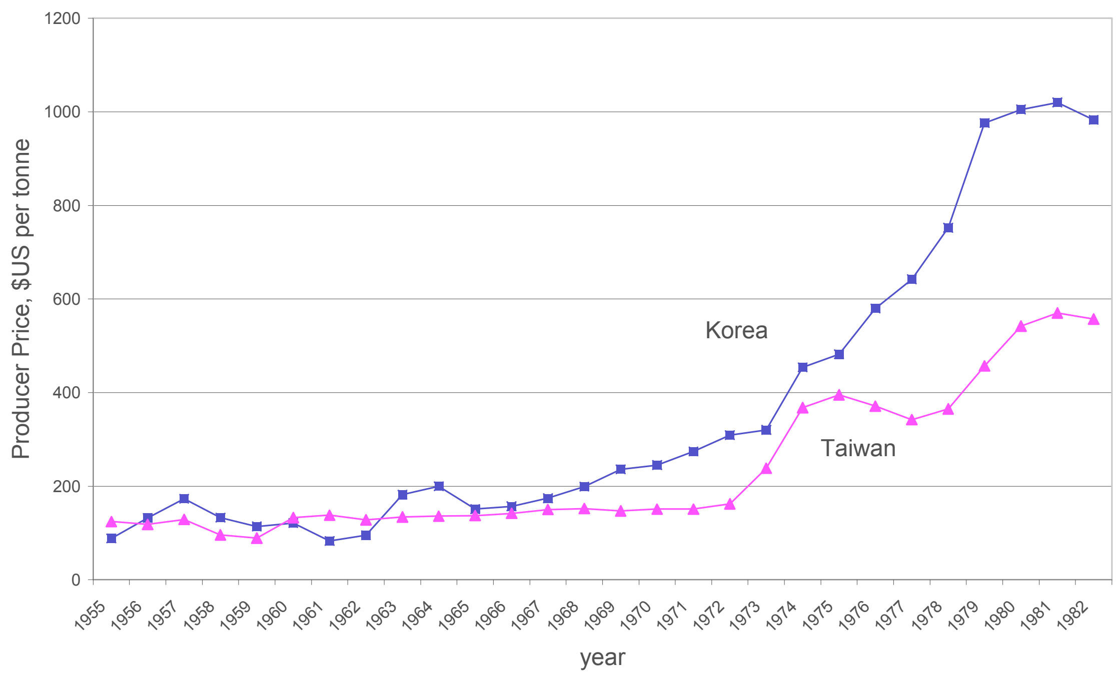
Source: World Bank (2003); National Statistical Office (1995); Republic of China (1984, 1990, 1997a); Republic of China (1990, 1997b)

Figure 3-4: Prices Received and Paid by Farmers



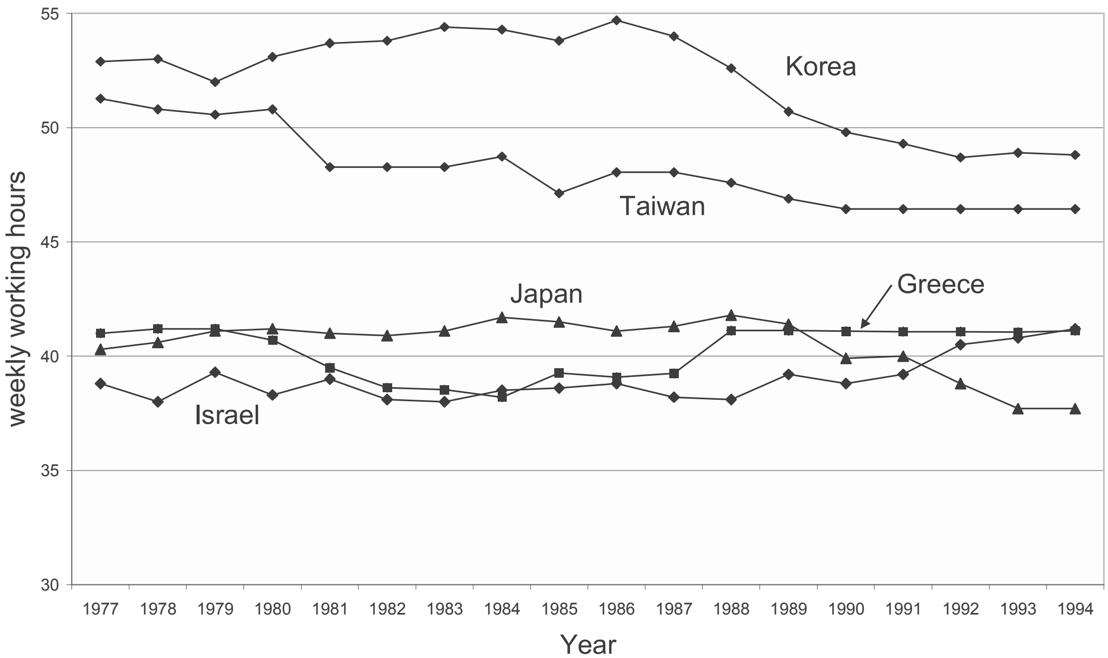
Source: World Bank (2003); National Statistical Office (1995); Republic of China (1984, 1990, 1997a); Republic of China (1990, 1997b)

Figure 3-5: Producer Rice Price in Taiwan and Korea



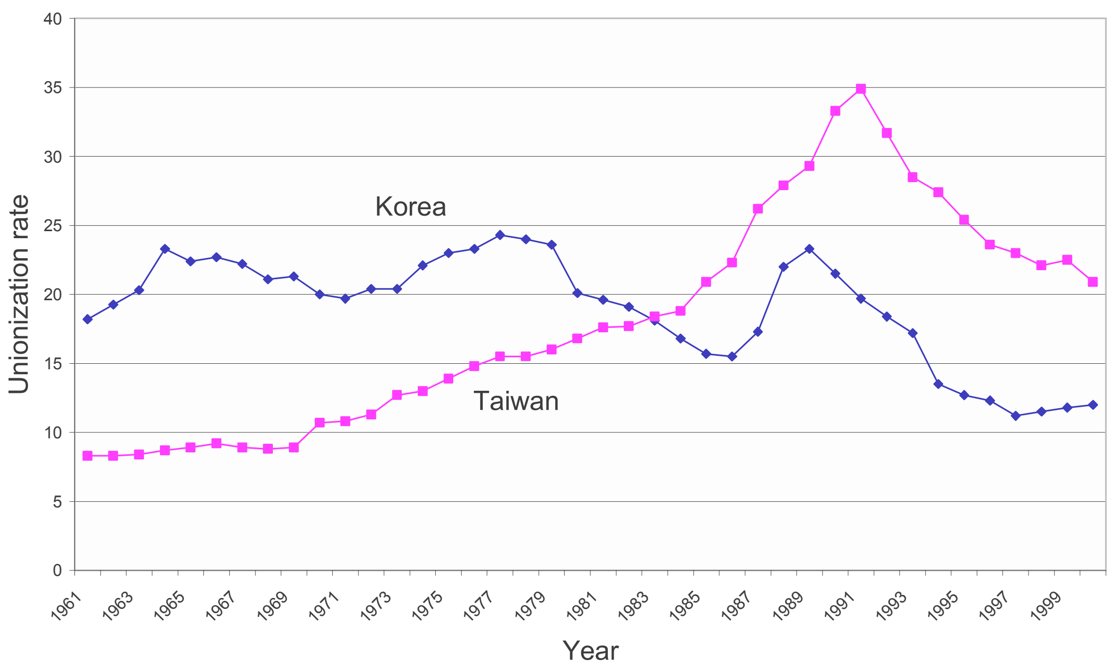
Source: Anderson and Hayami (1986: 130-4)

Figure 3-6: Weekly Working Hours



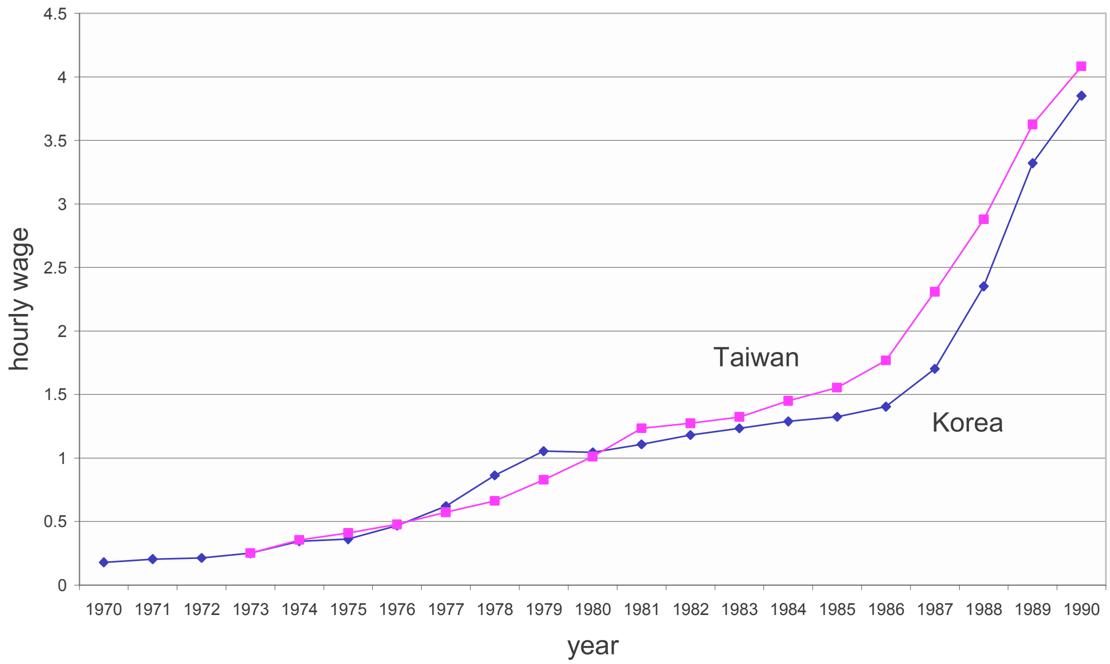
Source: ILO (1980, 1990, 2000); National Statistical Office (1995); Executive Yuan (1980, 1987, 1997)

Figure 3-7: Unionization Rates, 1961-2000



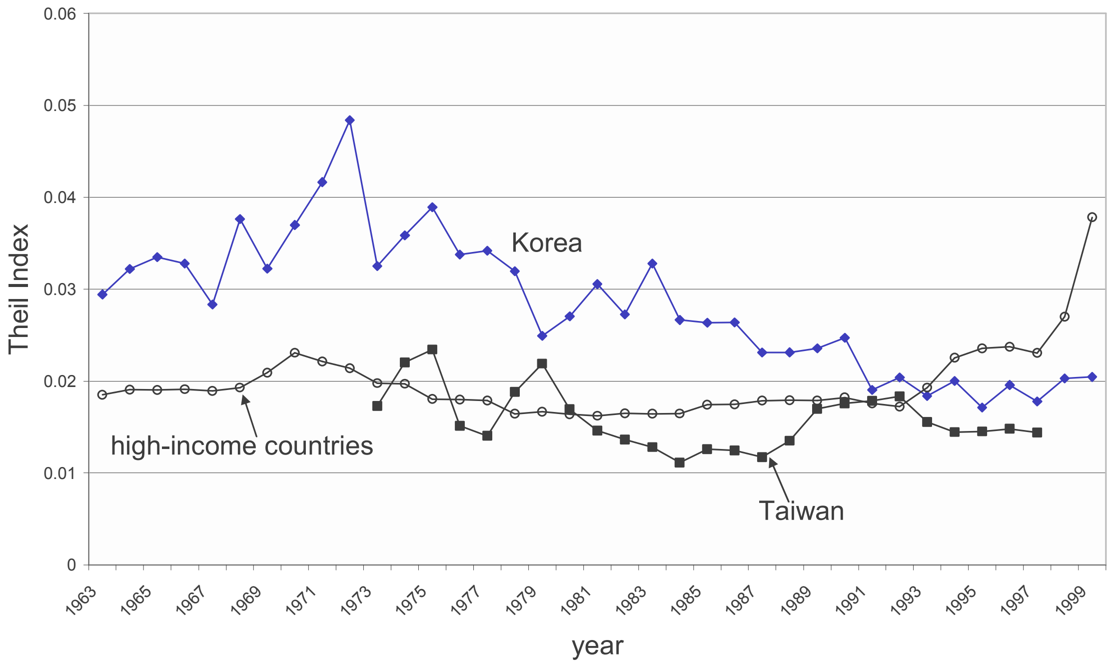
Source: National Statistical Office (1995: 399); Ministry of Labor (1970, 1980, 1993, 2000); Republic of China (1984, 1990, 1997a)

Figure 3-8: Hourly Wage in Korea and Taiwan (US$)



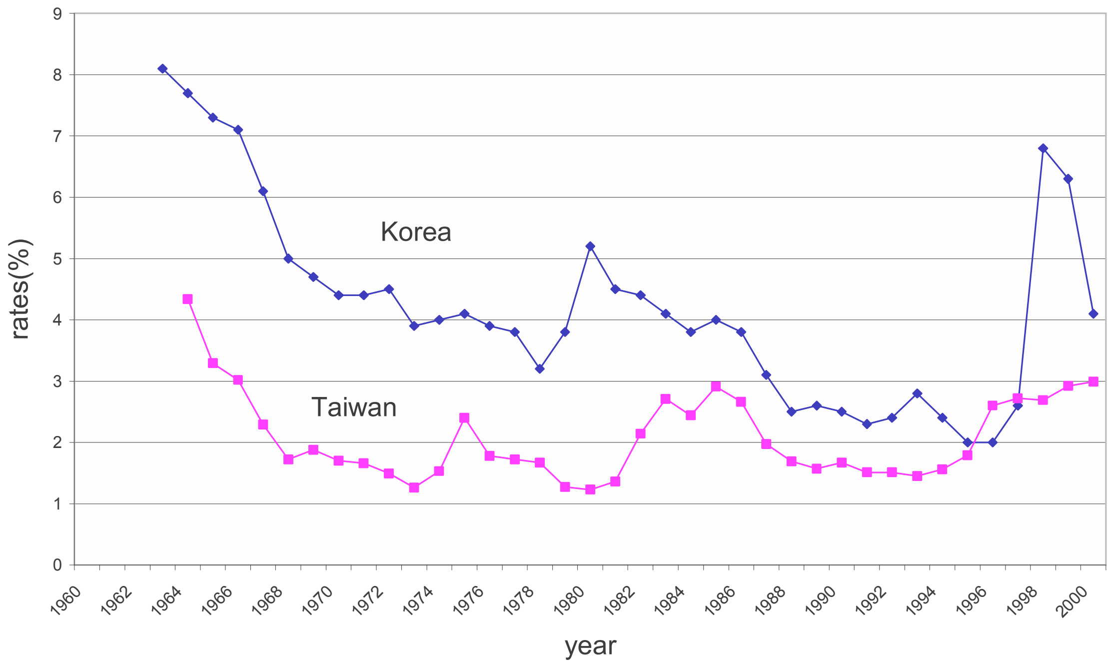
Source: National Statistical Office (1995: 383-4); Republic of China (1980, 1991)

Figure 3-9: Wage Differentials



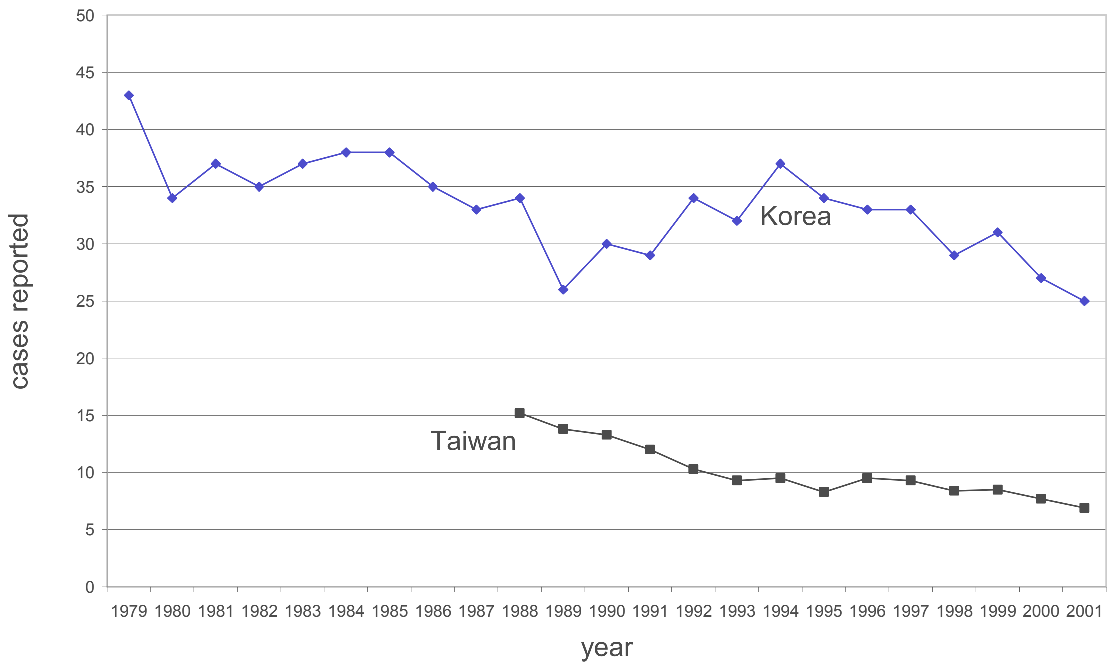
Source: University of Texas Inequality Project (http://utip.gov.utexas.edu/data.html), accessed May 16, 2005.

Figure 3-10: Unemployment Rates



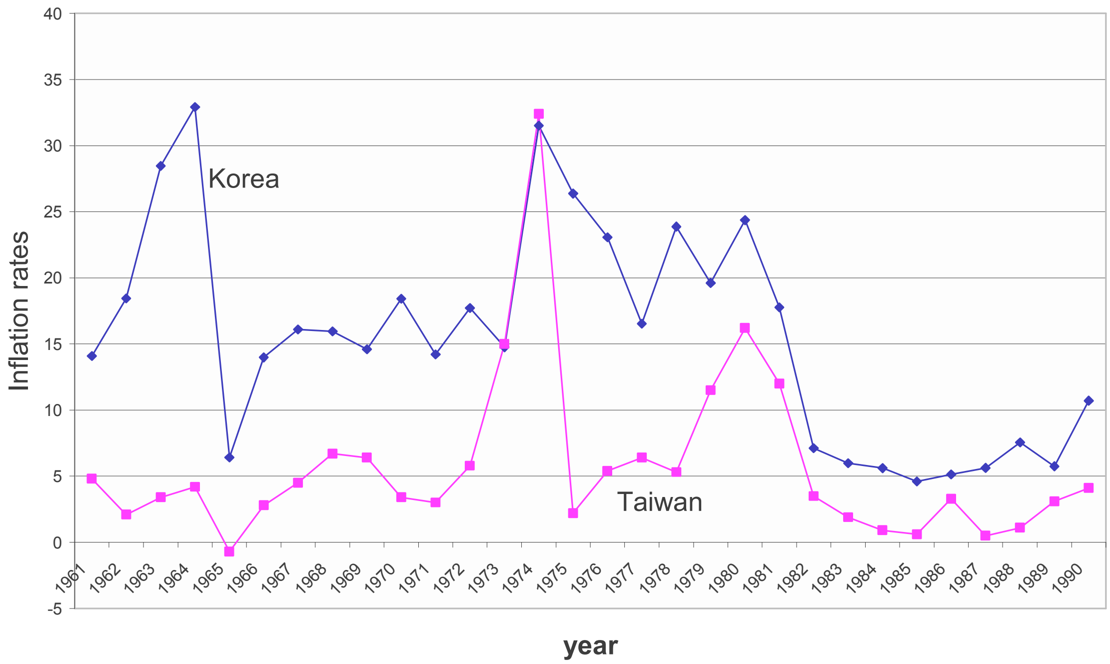
Source: National Statistical Office, Statistics Korea (1995: 373); World Bank (2003); Republic of China (1970, 1980, 1990, 2003).

Figure 3-11: Rates of Fatal Injury



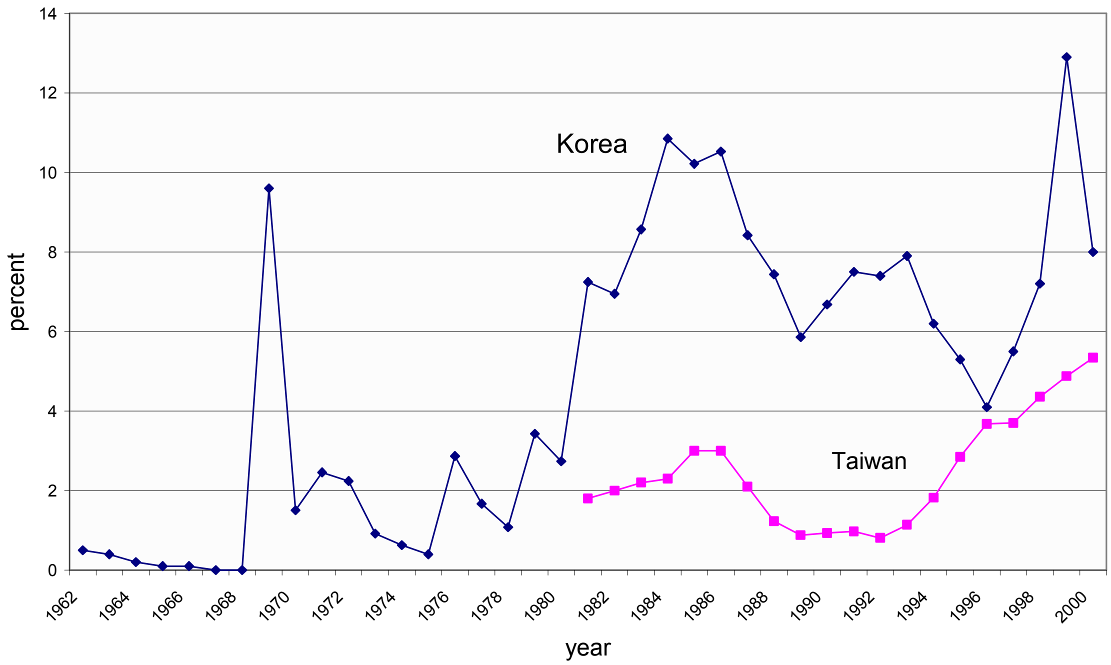
Source: ILO (1980. 1990. 2000. 2003); National Statistical Office (1995; 393); Occupational Safety & Health Agency (http://www.kosha.net/kosha/index.jsp), accessed June 15, 2005.

Figure 4-1: Inflation, 1961-90



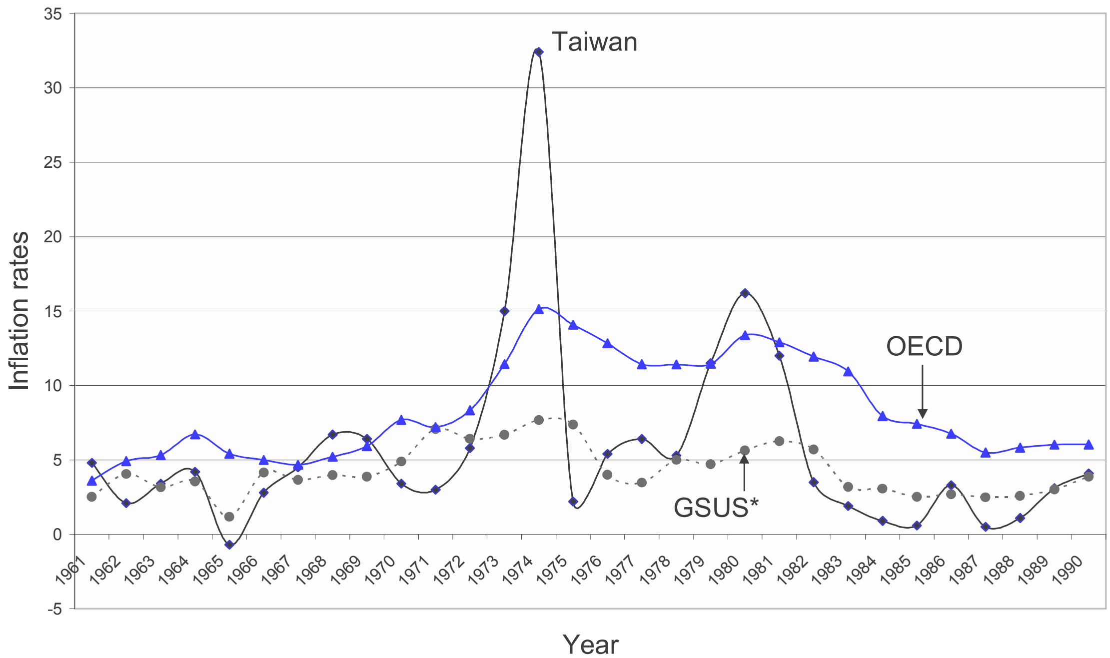
Source: World Bank (1993); Republic of China (1969, 1984, 1990, 1997a)

Figure 4-2: NPL Ratio of Total Credit



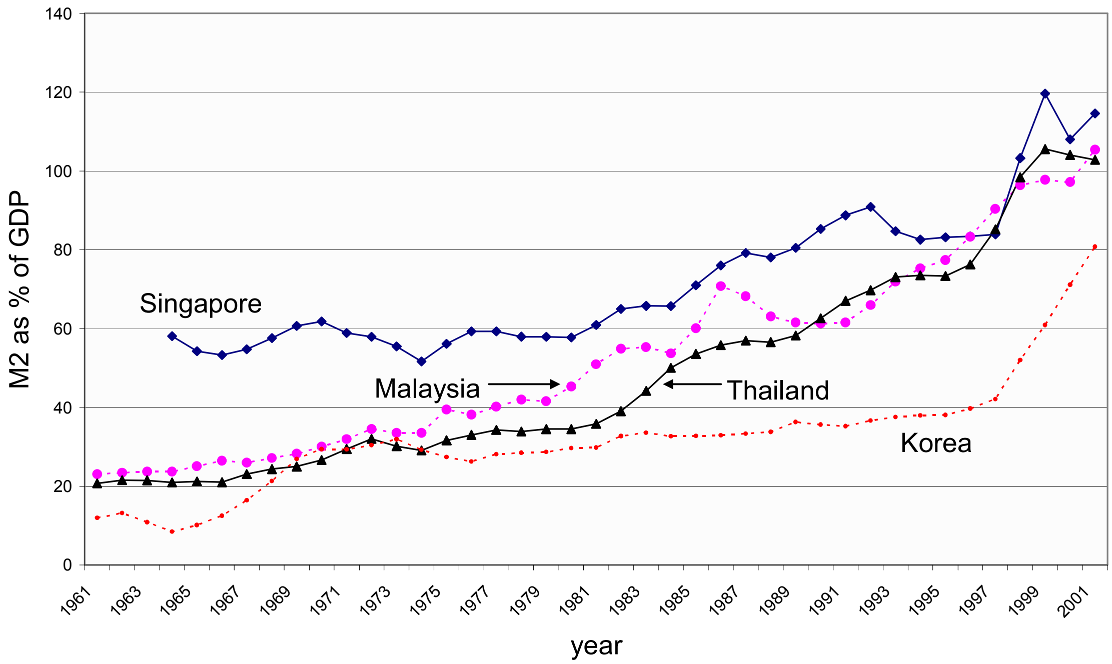
Source: email interview with CBC and FSS, July 2005.

Figure 4-3: Inflation rates in Taiwan, OECD, and GSUS*,1961-90



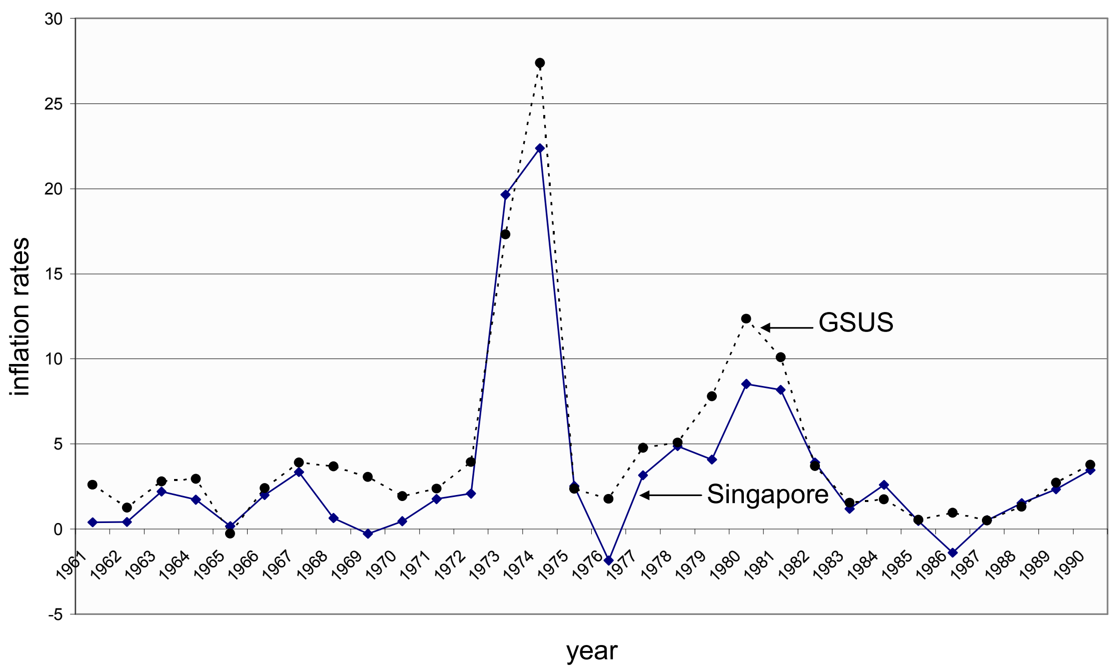
Source: World Bank (2003); Republic of China (1969, 1984, 1990, 1997a)
* GSUS is taken from average of inflation rates in Germany, Switzerland, and the U.S.

Figure 5-1: Financial Development in Four Countries, 1961-2001



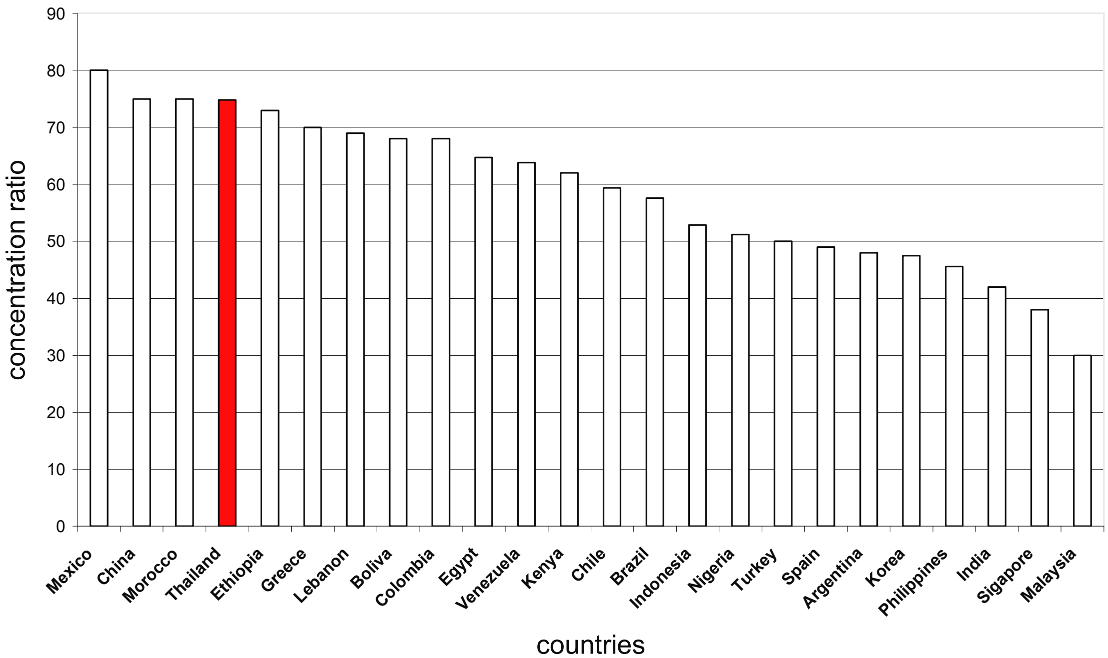
Source: World Bank (2003)

Figure 5-2: Inflation in Singapore and GSUS, 1961-90



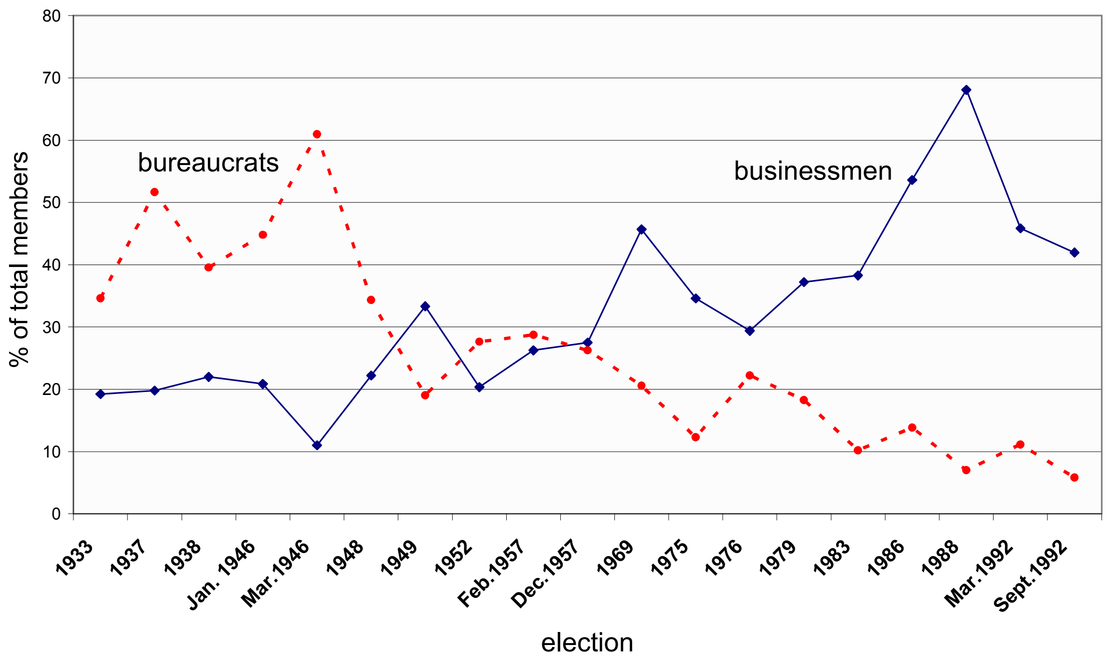
Source: World Bank (2003).
GSUS stands for Germany, Switzerland, and the U.S.

Figure 5-3: Asset Held by Top 5 Banks (% of Total Assets), 1999



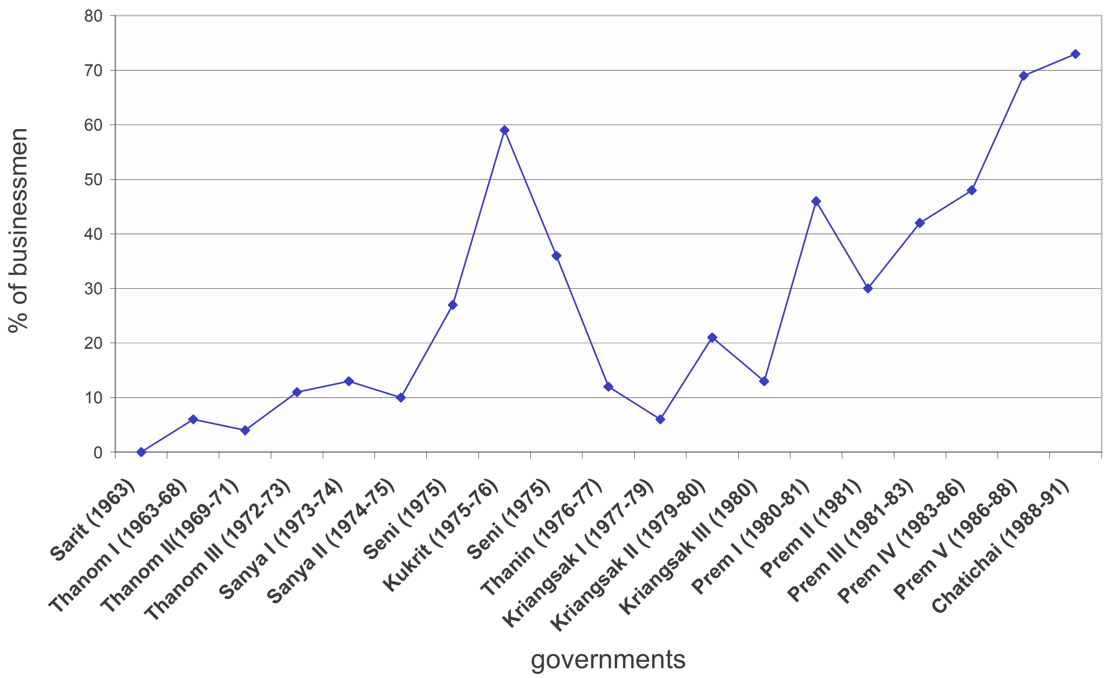
Source: Barth, Caprio, and Levine database (2001)

Figure 5-4: Background of Members of the Assembly, 1933-1992



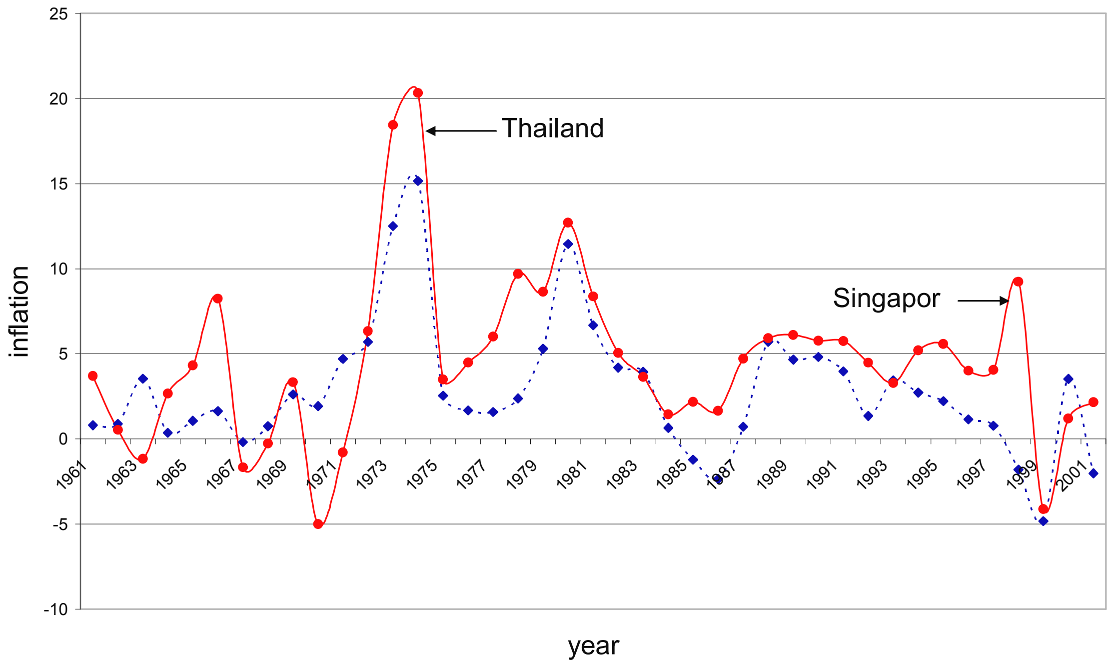
Source: Phongpaichit and Baker (1995: 338)

Figure 5-5: Share of Businessmen in the Thai Cabinet, 1963-1991



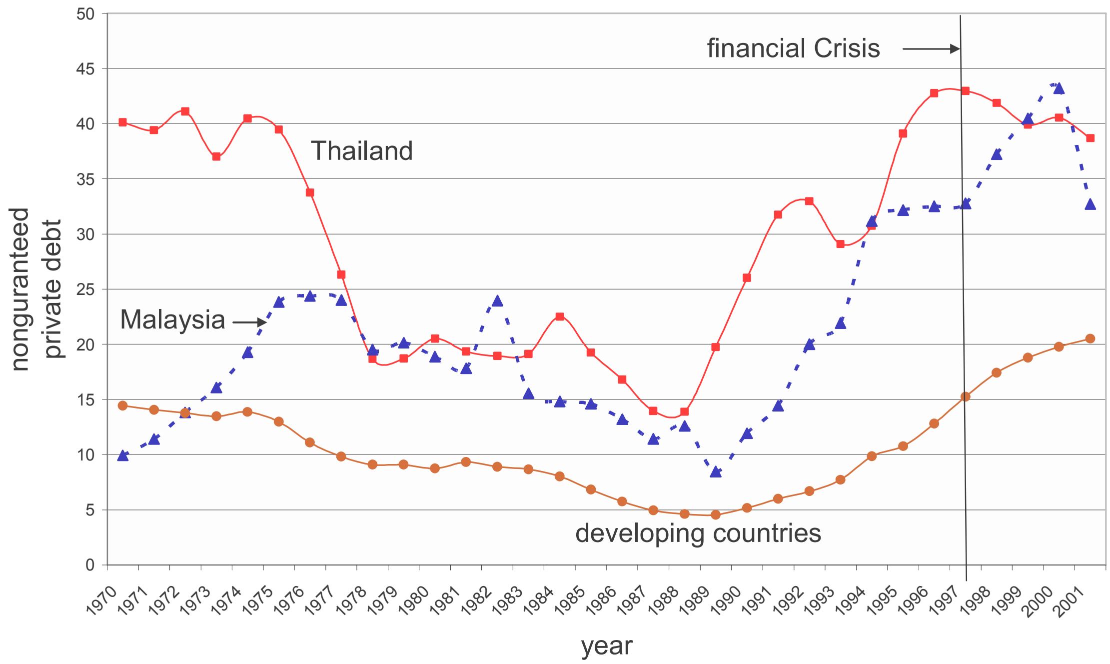
Source: Phongpaichit and Baker (1995: 339)

Figure 5-6: Inflation in Thailand and Singapore, 1961-2001



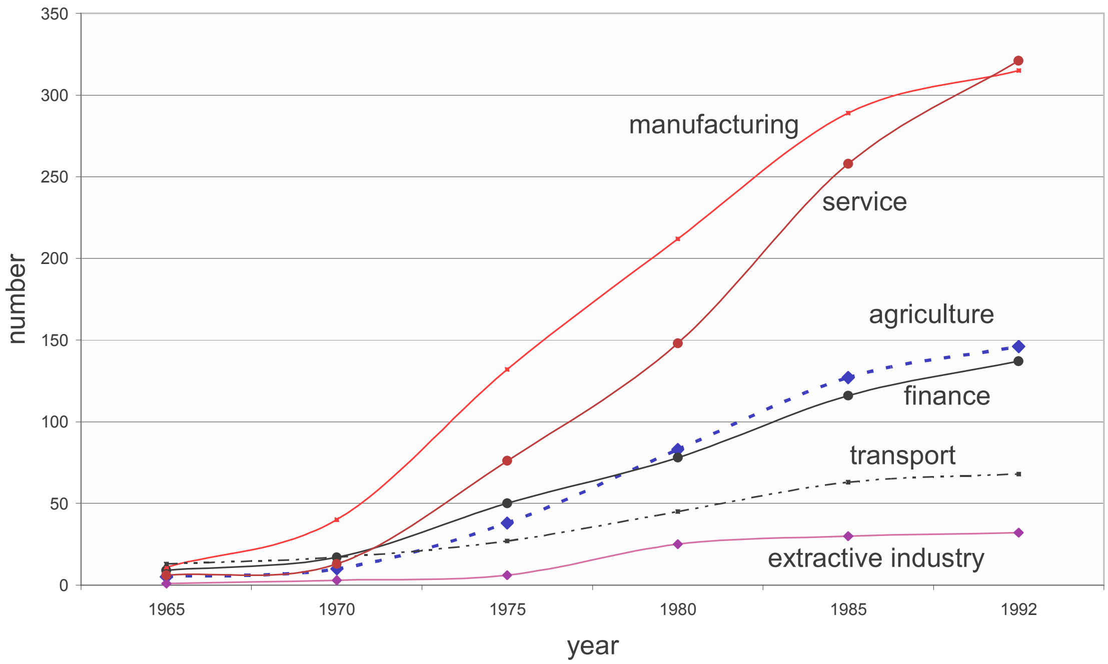
Source: World Bank (2003)

Figure 5-7: Non-Guaranteed Private debt (% of Total External Debt)



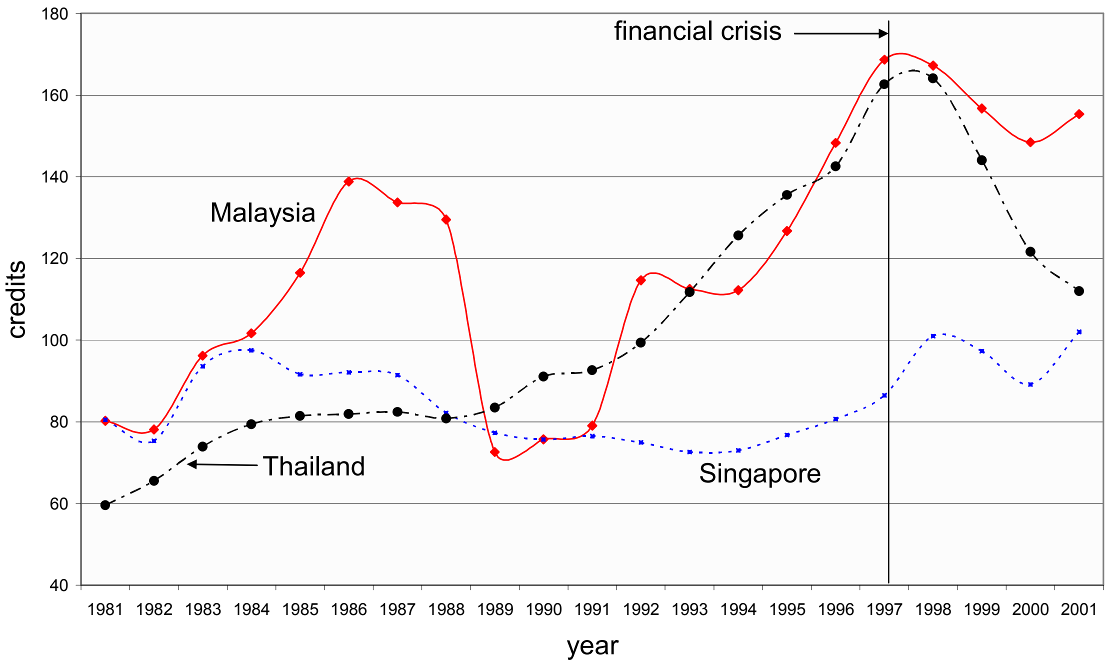
Source: World Bank (2003).

Figure 5-8: Number of Malay SOEs, 1960-92



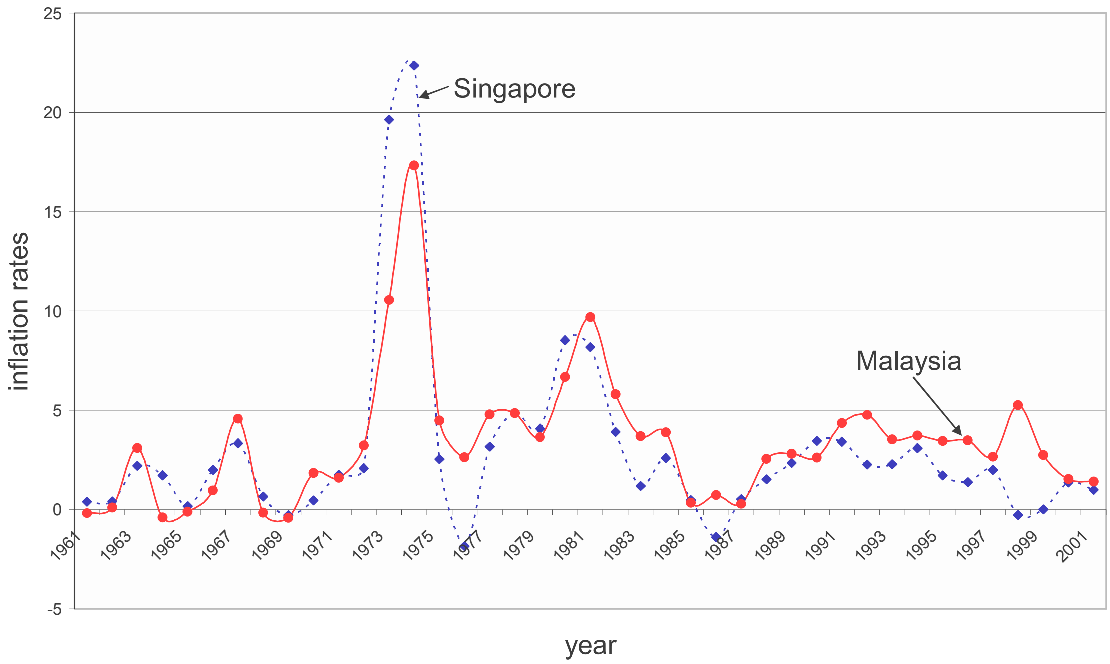
Source: Gomez and Jomo (1997: 31)

Figure 5-9: Credits by Banking Sector (% of GDP)



Source: World Bank (2003)

Figure 5-10: Inflation in Singapore and Malaysia, 1960-2001



Source: World Bank (2003)

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